No. 78-1789

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

ARKANSAS LOUISIANA GAS COMPANY, *Petitioner,*

v.

FRANK J. HALL, W. E. HALL, JR., MRS. W. E. HALL, SR., THE H. M. HARRELL TESTAMENTARY TRUST, JAMES E. HARRELL, JOHN K. HARRELL, SR., ASA BENTON ALLEN, SIDNEY G. MYERS, JR., W. O. COCHRAN, THOMAS F. PHILYAW, MRS. ELAINE ALLEN, JAMES A. NOE, D. B. McCONNELL, MRS. EVA L. WEISS, SOL KAPLAN and NATIONAL AMERICAN BANK, New Orleans, Co-Testamentary Executors of the SUCCESSION OF SEYMOUR WEISS, *Respondents.*

PETITIONER'S BRIEF ON THE MERITS

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PETITIONER'S BRIEF ON THE MERITS

QUESTIONS PRESENTED

(1)

Whether the court below erred as a matter of jurisdiction and law in awarding Respondents, as damages for breach of contract, a retroactive price increase for their natural gas sold to Petitioner in interstate commerce for resale which, aggregated with the price already paid under the contract, is a price higher than the Respondents' rate on file with the Commission in accordance with the *Natural Gas Act.*

(2)

Whether the Supreme Court of Louisiana erred in approving the actions of the trial court and of the Louisiana Court of Appeal in affirming their own jurisdiction and declining to refer to the Federal Energy Regulatory Commission ("FERC" or "Commission")[1] for decision the question of the interpretation of the favored nation price escalation provision of Respondents' FPC Rate Schedule, and

(a) whether, if the state court had jurisdiction, its finding that the favored nation provision was activated was correct, and

(b) if the favored nation provision was activated, whether the court below might determine (as it did) the prices that Respondents might legally collect from Petitioner under the *Natural Gas Act* and the Regulations thereunder.

(3)

Whether the ruling below as to the small producer status of Respondents was in accordance with the *Natural Gas Act* and the Commission Regulations.

PARTIES

The names of all parties to this proceeding are stated in the caption of the case in this Court, as given above.

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[1] Under the Department of Energy Organization Act, 42 U.S.C. Section 7172(a)(1)(C), (D), (E), and (F), the FERC succeeded to the relevant functions and responsibilities of the former Federal Power Commission ("FPC") on October 1, 1977. The term "Commission" refers to the FPC or the FERC, as the context indicates.

CASES: Page

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PETITIONER'S BRIEF ON THE MERITS

I. OPINIONS AND JUDGMENTS BELOW

The opinion and decree of the Supreme Court of Louisiana is reported at 368 So.2d 984 (La. 1979), J.A. 51. Petitioner's application to that court for rehearing was denied April 9, 1979, J.A. 68.

Earlier opinions in the suit are as follows:

Opinion of the First Judicial District Court, Caddo Parish, Louisiana, on the merits, J.A. 7, October 14, 1977.

Opinion of the district court denying new trial, J.A. 22, December 2, 1977.

Judgment of the trial court, J.A. 27, December 5, 1977.

Opinion and decree of the Court of Appeal, Second Circuit, State of Louisiana, J.A. 29, May 1, 1978, 359 So.2d 255.

Order of the Court of Appeal, Second Circuit, State of Louisiana, denying applications of Petitioner and Respondents for rehearing, J.A. 48, June 6, 1978.

Order of the Supreme Court of Louisiana denying Petitioner's application for review of the judgment of the Louisiana Court of Appeal, J.A. 50, September 22, 1978, 362 So.2d 1120.

Order of the Supreme Court of Louisiana granting Respondents' application for review of the judgment of the Louisiana Court of Appeal, J.A. 49, September 22, 1978, 362 So.2d 798.

Proceedings in the case subsequent to the judgment of the Supreme Court of Louisiana culminated in a money judgment against Petitioner and in favor of Respondents (J.A. 69, May 17, 1979) which was affirmed by the Louisiana Court of Appeal (J.A. 72, January 22, 1980, 379 So.2d 1142), review denied by the Supreme Court of Louisiana (J.A. 86, May 2, 1980, 383 So.2d 800), and which is sought by Petitioner to be reviewed in this Court by a petition for *certiorari*, No. 79-1896, pending at the time this brief is written. Copies of proceedings in the case subsequent to the judgment under review here are contained in the record as certified by the clerk of the state court and the opinions and judgments are in Joint Appendix B, J.A. 5, *et seq.*

II. JURISDICTION

The judgment of the Supreme Court of Louisiana was entered March 5, 1979, rehearing was denied on April 9, 1979, and the petition for *certiorari* was filed in this Court on May 29, 1979, within the time allowed by U.S. Code, Title 28, Section 2101(c). The judgment of the Supreme Court of Louisiana of which review and reversal are here sought is a final judgment within the meaning of the jurisdictional statute, U.S. Code, Title 28, Section 1257(3).

III. STATUTES AND REGULATIONS INVOLVED

Petitioner's claims in this suit are based upon the supremacy clause of the Constitution of the United States, Article VI, by reason of the fact that Petitioner has been denied its rights under Section 4 of the *Natural Gas Act,* 52 Stat. 822, 15 U.S.C. Section 717c, and Regulations thereunder of the Commission, *Code of Federal Regulations,* Title 18, Sections 154.92, 154.93, 154.94, 154.95 and 157.40, copies of which are attached in the appendix to this brief, pages 5a, 7a, 8a, and 13a respectively.

IV. STATEMENT OF THE CASE

Petitioner ("Arkla") is an integrated gas utility engaged in all phases of the natural gas business in Arkansas, Louisiana, Texas and Oklahoma, and to a limited extent in Kansas and Missouri. It is a "natural gas company" as that term is defined in Section 2(6) of the *Natural Gas Act,* subject to the jurisdiction of the Commission.[2] Respondents are engaged in the production of natural gas and the sale thereof to Arkla in interstate commerce for resale. Respondents also are "natural gas companies," as defined in Section 2(6) of the *Natural Gas Act,* subject to the jurisdiction of the Commission.[3]

On January 11, 1952, Respondents, or their predecessors, entered into a written agreement with Arkla (reproduced at J.A. 87) providing for the sale at the wellhead to Arkla of the entire natural gas stream (including the liquefiable hydrocarbons contained in

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[2] The *Natural Gas Act,* 15 U.S.C. Section 717a(b), defines "natural gas company" as "a person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale."

[3] *Phillips Petroleum Co.* v. *Wisconsin,* 347 U.S. 672 (1954).

the stream of natural gas but not condensate, *i.e.,* oil) to be produced from Respondents' wells in the Sligo Gas Field, Bossier Parish, Louisiana, for a primary term expiring in 1980.[4] After *Phillips Petroleum Company, supra,* Respondents filed for and received a Certificate of Public Convenience and Necessity from the Commission authorizing the sales. The 1952 contract was filed with the Commission and became Respondents' FPC Gas Rate Schedule No. 4. Under the price provisions of this contract, the price per one thousand cubic feet (Mcf) to be paid by Arkla to Respondents for wet gas was $0.06997 with escalations each five years until the price became $0.11496 in 1975.[5]

Section 8(D) of Respondents' Rate Schedule contains the escalation provision which the parties refer to in this suit as the "favored nation provision." So far as here relevant, the provision is as follows (J.A. 99-100):

> "If at any time during the term of this agreement Buyer should purchase from another party seller gas produced from the subject wells or any other

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[4] All natural gas when produced contains in varying degrees liquefiable hydrocarbons in a gaseous state. Natural gas including these liquefiable hydrocarbons is known as wet gas. These liquefiable hydrocarbons are extractable and after extraction and processing are saleable in liquid form as a separate product. When natural gas is sold excluding the extractable hydrocarbons, the sale is known as a sale of dry gas. Under the contract Respondents sold Arkla wet gas. The Commission's rate regulations prescribe the same maximum rate for wet and dry gas. The court below awarded Respondents the market value of the extracted liquid hydrocarbons in addition to the price of gas as though the sale was only of dry gas, thereby awarding Respondents a rate almost twice the maximum rate permitted by the Commission.

[5] The term "price" is synonomous with the term "rate or charge" as used in Sections 4 and 5 of the *Natural Gas Act,* 15 U.S.C. Sections 717c and d.

well or wells located in the Sligo Gas Field at a higher price than is provided to be paid for gas delivered under this agreement, then in such event the price to be paid for gas thereafter delivered hereunder shall be increased by an amount equal to the difference between the price provisions hereof and the concurrently effective higher price provisions of such subsequent contract; provided that in determining whether a given price is in fact 'higher' than the price provisions of this contract, the inquiry shall not be limited to the actual prices stipulated but due consideration shall also be given to a comparison of all other pertinent provisions of the two contracts, such as point of delivery, basis of measurement, taxes, dehydration, and delivery pressures (provided that the number of years stated as the terms during which the two contracts shall respectively remain in force and effect shall not be a factor to be considered for purposes of comparison under this paragraph) and the price to be thereafter payable in accordance with this paragraph for gas delivered hereunder shall be adjusted accordingly insofar as may be necessary to make allowances for any discrepancies as may exist between such comparable provisions of the two contracts. It is agreed that any such higher price for gas delivered hereunder shall be effective on the first day of Buyer's accounting month (as elsewhere herein defined) next following the effective date of such subsequent contract, all subject, however, to any rules and regulations of the Office of Price Stabilization or any other regulatory body having jurisdiction."

Proceedings in the Trial Court

This suit was begun in 1974 in the First Judicial District Court of Louisiana in and for Caddo Parish. The original petition of the Plaintiffs, Respondents herein, (R. 13) claimed that payments made by Arkla to the United States (which were made beginning in 1961) as royalty under an oil and gas lease (covering parts

of the Barksdale Field Reservation in Bossier Parish in the Sligo Gas Field) (J.A. 121) constituted purchases of gas from a "party seller" and "triggered" the favored nation provision; and that Arkla thereby incurred substantial liabilities to Respondents for higher rates for gas sold. Respondents' original petition was superseded by an amended petition (R. 763) stating Respondents' claims in terms of damages for breach of contract, measured by the difference between the rate paid by Respondents under the Rate Schedule and the royalty payments under the lease. Petitioner raised and preserved federal defenses, including the defense that primary and exclusive jurisdiction over the issues was in the Commission under the *Natural Gas Act* and that the state court was without subject matter jurisdiction.

Under the provisions of the lease, the United States government, at its option, was entitled to a royalty either of 16⅔% of the volume of the production obtained from the leased lands or its value. Under the terms of the government lease and the authority of the *Mineral Leasing Act,* 30 U.S.C. Sections 226, *et seq.*, the Department of the Interior, acting through the United States Geological Survey, had the right to make a binding determination as to the values of the extracted liquid hydrocarbons and gas produced by the lessee for the purpose of computing the amount of the value royalties. The government exercised this right by notice to Arkla fixing separate values for gas and extracted liquid hydrocarbons produced by Arkla under the government lease. Arkla has paid royalties to the United States under the government lease, calculated as 16⅔% of the separate values of Arkla's 15% of the production from the government lease of both residue gas and liquid hydrocarbons, determined, as required by the lessor, with no deduction for the cost of extraction and processing. Since the unit values re-

quired by lessor for the royalty payments for gas were higher than Respondents' wellhead price to Arkla, Respondents claimed that the favored nation provision was triggered.

Opinions and Judgment of Trial Court

The Louisiana District Court entered two opinions —on October 14, 1977 (J.A. 7) and on December 2, 1977 (J.A. 22). That court held that as a matter of Louisiana oil and gas law, the United States owned the royalty percentage (16⅔%) of the gas as it was produced, that, therefore, the value royalty paid by Petitioner was paid as the sales price for gas sold by the government to Arkla, and that, consequently, the royalty payments triggered the favored nation provision of the contract.

The trial court also held, on the authority of the Louisiana decision of *Interstate Natural Gas Co.* v. *Mississippi River Fuel Corp.*, 220 La. 43, 55 So.2d 775 (1951), that Respondents could not recover a higher price (*i.e.*, a rate increase) for gas sold during the period 1961 to October, 1972 (at which latter date the court held that Respondents attained the status of small producers [6]) because they had made no Commission filing for the increased contractual rate as required by the *Natural Gas Act*. The court granted them judgments (J.A. 27) for its calculated "favored nation"

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[6] Under the Commission Regulations, 18 C.F.R. Section 157.40, a small producer is excused from the rate-change filing requirements of Section 4(d) of the *Natural Gas Act*, which are among the prerequisites to the right to charge increased rates. Another prerequisite is that the contract confer on the seller a right to charge the rate unilaterally. *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956); *Shell Oil Co., et al.*, 29 FPC 498 (1963), *aff'd., Shell Oil Co.* v. *FPC*, 334 F.2d 1002 (3d Cir. 1963).

price increase for the period October, 1972, through December, 1975.

The demands of one of the Respondents, W. E. Hall, Jr., were rejected on the ground that he had agreed to an amendment of his contract with Arkla deleting the favored nation provision, and this ruling has been affirmed both in the Louisiana Court of Appeal and the state Supreme Court. It should also be stated that by an earlier opinion (J.A. 5) the District Court had entered an interlocutory order overruling Petitioner's declinatory exception to the court's jurisdiction. The exception was based on the ground that the Commission was vested with primary and exclusive jurisdiction over the questions presented by the lawsuit.[7]

Opinions of Court of Appeal

On appeal by all parties to the Louisiana Court of Appeal, Second Circuit, that court rejected the trial court's finding that the federal government owned the royalty percentage of the gas and sold it to Arkla. The Court of Appeal found further that Arkla's payments to the federal government were payments of rent and were not the payment of the price of a sale. Nevertheless, the Court of Appeal affirmed the trial court's

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[7] Following the overruling of its declinatory exception, Petitioner filed a petition with the Commission for a declaratory order construing Respondents' Rate Schedule and determining the rates at which each of Respondents was entitled to be paid in the period involved in this suit. Although agreeing that it had jurisdiction, the Commission ruled that since an action was pending in the state court, it would defer to the state court and declined to entertain the petition. The Commission's orders are on review in the United States Court of Appeals for the District of Columbia Circuit (Case Nos. 77-1146 and 79-2068, *Arkansas Louisiana Gas Co.* v. *FERC*), where the review proceedings are now pending.

judgment in all respects except as to *quantum*, saying (J.A. 36):

> "We nevertheless find it inappropriate to accept the technical and restrictive interpretation on the term 'purchase from another party seller' relied on by defendant under the circumstances shown in this instance."

The court concluded that the favored nation provision should be construed in the interest of the seller and held that it was activated.

As to *quantum*, the Court of Appeal reversed and remanded the judgment for recalculation with directions in accordance with its opinion.

Proceedings in and Opinion of the Louisiana Supreme Court

Respondents applied to the Supreme Court of Louisiana for review of the Court of Appeal's judgment and decree insofar as they rejected their demands, and Petitioner applied for review of that part of the judgment against it. Respondents' application was granted and Petitioner's application was denied by separate orders entered September 22, 1978 (J.A. 49 and J.A. 50).

The decision of the Supreme Court of Louisiana (J.A. 51) amended the judgment entered by the Louisiana Court of Appeal, Second Circuit, by awarding higher rates to Respondents for the period of time Respondents had not complied with the applicable filing requirements of the *Natural Gas Act* and the Commission's Regulations which were a prerequisite to the right to collect the higher rates.[8] The Supreme Court of

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[8] The Court of Appeal had previously determined that Respondents could not collect higher rates during this period of time that they were subject to the rate increase filing requirements of Section 4(d) of the *Natural Gas Act*, 15 U.S.C. Section 717c(d) (J.A. 40-41). The period of time involved was that period before several of the Respondents achieved small producer status in October, 1972.

Louisiana determined that Respondents were prevented by Arkla from fulfilling the rate increase filing requirements of the *Natural Gas Act* because Respondents were not informed that Petitioner had made market value royalty payments to the United States government, which royalties were calculated on the basis of higher values than the prices paid by Petitioner to Respondents (J.A. 60).[9] The court held that in these circumstances, Respondents were excused from compliance with the *Natural Gas Act,* saying (J.A. 60-61):

> "Pursuant to article 2040 [of the Louisiana Civil Code] and this court's jurisprudence interpreting that article, the condition (that [Respondents] file new rate schedules) is considered fulfilled. Hence [Respondents'] failure to file new rate schedules in no way precludes [Respondents'] recovery of damages for the entire period of [Petitioner's] breach (September 1961 through December 31, 1975) as measured by the differences in the price [Petitioner] paid the United States government and the price [Petitioner] paid [Respondents]. To hold otherwise would be in clear contravention of the spirit and intent of article 2040 and the jurisprudence of this court."

The court also determined that having eliminated the statutory rate increase filing requirements under

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[9] The foundation of the decision was the "triggering" issue—that is, whether Petitioner's market value royalty payments triggered the favored nation provision in Respondents' FPC Rate Schedule. Having denied Petitioner's application for review, the Supreme Court of Louisiana applied the Court of Appeal's determination that triggering had occurred. It is Petitioner's position that the triggering issue should have been referred to the Commission for decision and that the state court decision is contrary to federal regulatory law. *Mobil Oil Corp.* v. *FPC,* 463 F.2d 256 (D.C. Cir. 1971), *cert. denied sub nom., Mobil Oil Corp.* v. *Matzen,* 406 U.S. 976 (1972).

the *Natural Gas Act* it could determine the rate that the Commission would have authorized Respondents to collect.[10]

The Supreme Court of Louisiana remanded the proceeding to the state District Court for a calculation of the price increase to be awarded Respondents in the form of damages for breach of contract (J.A. 66).

V. SUMMARY OF ARGUMENT

I.

The state court undertook to construe the favored nation provision in Respondents' Rate Schedule on file with the Commission and concluded that Petitioner's royalty payments under a United States government lease triggered the favored nation provision and entitled Respondents to an increase in rates for their sales of natural gas for resale in interstate commerce to Petitioner. The state court awarded Respondents an increase in rates based on this conclusion.

The state court thereby usurped the Commission's jurisdiction since such sales and the rates therefor are conclusively within the Commission's exclusive jurisdiction under the *Natural Gas Act*. *Phillips Petroleum Co.* v. *Wisconsin,* 347 U.S. 672 (1954); *Natural Gas Pipeline Co.* v. *Panoma,* 349 U.S. 44 (1955).

The state court's effort to avoid this usurpation of the Commission's jurisdiction by labeling the increased rates as "damages" is unavailing. The state court "cannot separate what Congress has joined together." *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.,* 341 U.S. 246, 251 (1951).

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[10] As Petitioner hereinafter shows, this ruling emphasizes the court's error in failing to refer to the Commission these matters which involve its primary and exclusive jurisdiction. These matters should not be the subject of speculation by the courts. See *infra,* pp. 26-37.

Rates are at the heart of the matter. Respondents cannot show damage save by showing that the Commission would approve some rate structure and some practice other than the presently effective rate structure on file with the Commission. *Interstate Natural Gas Co.* v. *Southern California Gas Co.,* 102 F.Supp. 685 (S.D. Ca. 1952); *Atlantic Richfield Co.* v. *Northern Natural Gas Co.,* No. CA-3-1548-G (N.D. Texas, filed December 1, 1977), *appeal docketed,* No. 78-1112 (5th Cir. 1978). Indeed, the state court in order to award the "damages" found it necessary to rule that Respondents were excused from the rate-change filing requirements of the *Natural Gas Act* [Section 4(d)] and that the Commission would have allowed the increased rate established by the state court to assess damages. As the Commission has said of the state court's judgment: "the Louisiana courts have, in effect, determined a rate that, in their view should have been the just and reasonable rate—a determination that is within this Commission's exclusive jurisdiction." Supplemental Memorandum For the United States and the Federal Energy Regulatory Commission as *Amici Curiae,* App. 11a, n. 15, on petition for *certiorari* in this case.

The judgment of the state court also violated the filed rate doctrine which means in the context of the *Natural Gas Act* that a natural gas company can claim no rate as a legal right that is other than the filed rate and that not even a court can authorize commerce in the commodity on other terms. ***Montana-Dakota, supra.***

II.

The Louisiana courts' decisions wrongfully intrude upon the Commission's primary jurisdiction. ***Texas & Pacific R. Co.*** **v.** ***Abilene Cotton Oil Co.,*** **204 U.S. 426 (1907);** ***United States*** **v.** ***Western Pacific Railroad Co.,***

352 U.S. 59 (1956); *San Diego Bldg. Trades Council* v. *Garmon,* 359 U.S. 236, 242-43 (1959). The Commission's plenary rate jurisdiction extends to and includes all matters relating to the determination of the rate to be charged and collected in gas sales transactions subject to the *Natural Gas Act.* It includes the primary jurisdiction to interpret a rate schedule which would affect the rate applicable to the transaction especially when the Commission's expertise is involved or when the need for uniformity exists. *Northern Natural Gas Co.* v. *State Corp. Commission,* 372 U.S. 84, 85, 92 (1963); *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.,* 350 U.S. 332 (1956); *United Gas Pipe Line Co.* v. *Memphis Light, Gas & Water Division,* 358 U.S. 103, 114 (1958); *Appalachian Power Co.* v. *FPC,* 529 F.2d 342, 351 (D.C. Cir. 1976), *cert. denied,* 429 U.S. 816 (1976); *Zachary* v. *FERC,* 621 F.2d 155 (5th Cir. 1980); *Texas Oil & Gas Corp.* v. *Valley Gas Transmission, Inc.,* 608 F.2d 231, 234 (5th Cir. 1979); *Atlantic Richfield Co.* v. *Northern Natural Gas Co., supra.*

Under the *Natural Gas Act,* although contracts are initially established by the parties through private agreement, once the contracts are filed with the Commission as rate schedules under Section 4(c) of the Act, the full panoply of the Commission's rate authority attaches to the contract. *Id.;* see also *Carter* v. *AT&T Co.,* 365 F.2d 486, 496 (5th Cir. 1966): ". . . a tariff, required by law to be filed, is not a mere contract. It is the law." The "paramount and exclusive" jurisdiction of the Commission over a gas sales contract on file with the Commission as a rate schedule has been judicially recognized. *Id.*

The Commission has regularly interpreted the contracts on file with it as rate schedules and the courts have uniformly recognized the Commission's authority

to interpret contracts as an essential element of its rate regulation. *United Gas Pipe Line Co.* v. *Memphis Light, Gas & Water Division, supra.* Additionally, the courts have deferred to the Commission's expertise and competence with respect to technical matters and industry practices which are the Commission's daily fare. *Indiana & Michigan Electric Co.* v. *FPC,* 530 F.2d 1060, 1062 (D.C. Cir. 1976); *New England Power Co.* v. *FERC,* 571 F.2d 1213 (D.C. Cir. 1977); Cf. *Western Union Telegraph Co.* v. *FCC,* 541 F.2d 346, 351, 357, n. 7 (3d Cir. 1976), *cert. denied,* 429 U.S. 1092 (1977). Indeed, due to the Commission's special competence, expertise and the deference accorded the Commission's interpretations in matters subject to its rate authority, even legal questions and matters that do not involve its rate authority have been referred to the Commission under the doctrine of primary jurisdiction to secure its opinion in the first instance. *J. M. Huber Corp.* v. *Denman,* 367 F.2d 104, 111-12 (5th Cir. 1966); *Mississippi Power & Light Co.* v. *United Gas Pipe Line Co.,* 532 F.2d 412, 417 (5th Cir. 1976); *Carter* v. *AT&T Co., supra,* 365 F.2d at 498.

This case requires the Commission's expertise and the uniform application of regulatory policy regarding the triggering of a favored nation provision in a producer's sales contract. *Zachary* v. *FERC, supra; Atlantic Richfield Co.* v. *Northern Natural Gas Co., supra.* The Commission has considered this precise issue on many occasions and has developed a regulatory policy as to triggering. *Shell Oil Co., et al.,* 29 FPC 498, 499 (1963), *aff'd., Shell Oil Co.* v. *FPC,* 334 F.2d 1002 (3d Cir. 1963); *West Texas Gathering Co.,* 29 FPC 510 (1962); *Morris Mizel, et al.,* 30 FPC 1103, 1104 (1963). Recognition of the Commission's primary jurisdiction to decide the contract triggering issue is inseparable from the Commission's exclusive rate juris-

diction. *Atlantic Richfield Co.* v. *Northern Natural Gas Co., supra; Zachary* v. *FERC, supra.*

In the determination of whether the lease royalty payments made by Petitioner to the government were in fact higher than the sales rate paid to Respondents, and if so, how much higher, the Rate Schedule itself, in addition to the Commission's policy regarding triggering, requires an examination of other technical provisions of the Rate Schedule (*e.g.,* the point of delivery, payment for extracted products, basis of measurement, taxes, dehydration and delivery pressures). Additionally, Respondents have argued that they are entitled to separate recovery for "residue gas" and for "extracted plant products." These matters clearly involve the Commission's expertise. The excessive level of the retroactive rate increase awarded by the Louisiana courts also demonstrates that the issue regarding triggering of the favored nation provision is inseparable from the Commission's exclusive rate jurisdiction.

The Louisiana court's finding that the favored nation provision was activated is incorrect because it is inconsistent with the controlling federal regulatory law. *Northern Natural Gas Co.* v. *State Corp. Commission, supra; United Gas Improvement Co.* v. *Continental Oil Co.,* 381 U.S. 392, 400 (1965); *Textile Workers Union* v. *Lincoln Mills,* 353 U.S. 448 (1957); *Local 174* v. *Lucas Flour Co.,* 369 U.S. 95, 103 (1962). Petitioner's payment of lease royalties to the United States government did not activate the favored nation provision under federal regulatory law which controls the triggering issue. *Appalachian Power Co.* v. *FPC, supra; California* v. *Southland Royalty Co.,* 436 U.S. 519, 530-31 (1978); *Jicarilla Apache Tribe* v. *FERC,* 578 F.2d 289, 292 (10th Cir. 1978). The settled federal regulatory law is that a royalty settlement under an ordinary

market value lease is not in fact a sale of gas. *Mobil Oil Corp.* v. *FPC,* 463 F.2d 256, 262 (D.C. Cir. 1971), *cert. denied sub nom., Mobil Oil Corp.* v. *Matzen,* 406 U.S. 976 (1972). This rule has been applied consistently by the courts and the Commission in the interpretation of favored nation provisions. *Morris Mizel, et al., supra; Jicarilla Apache Tribe* v. *FERC, supra.* The Louisiana court's interpretation of the favored nation provision is also at odds with the plain terms of the agreement itself which specified that triggering would occur only if there were a "purchase from another party seller" and distinguished between a purchase and a royalty transaction. The holding by the Louisiana court that the contract should be interpreted broadly so as to favor the seller is wholly inconsistent with the dominant price reducing purpose of the *Natural Gas Act. Phillips Petroleum Co.* v. *Wisconsin, supra; United Gas Improvement Co.* v. *Continental Oil Co., supra.* There are adverse policy implications for the gas industry resulting from the Louisiana court's interpretation of the favored nation provision. Martin, *The Work of the Louisiana Appellate Courts for the 1978-1979 Term—Mineral Rights,* 40 La.L.Rev. 588, 601 (1980).

III.

The Louisiana courts erred (i) in determining which of the 15 independent producers who are Respondents herein are "small producers," and (ii) in determining that the small producer exemption from certain rate filing requirements removed the cause of action from the Commission's primary and exclusive jurisdiction under the *Natural Gas Act.*

The Louisiana courts wrongfully interpreted these regulations as permitting the courts to award a retroactive rate increase in the guise of damages during the

period that Respondents were alleged to be small producers.

The Commission's primary and exclusive jurisdiction extends to small producers. *Phillips Petroleum Co.* v. *Wisconsin, supra; FPC* v. *Texaco, Inc.*, 417 U.S. 380 (1974); *Jicarilla Apache Tribe* v. *FERC, supra.* Small producers are subject to the Commission's exclusive rate regulation under the *Natural Gas Act. Id.* Similarly, small producer contract disputes fall within the Commission's primary jurisdiction. *Zachary* v. *FERC,* 621 F.2d 155 (5th Cir. 1980); *Jicarilla Apache Tribe* v. *FERC, supra.*

Only 5 of the 15 independent producers who are Respondents here are small producers under the Commission's regulations, 18 C.F.R. Section 157.40. If the Louisiana court's decision is upheld, the 10 Respondents who have not qualified as small producers would collect the higher rates set by the court without a proper regulatory determination that they are entitled to collect such higher rates.

VI. ARGUMENT

I. The Decision Below Has Usurped the Commission's Exclusive Rate Jurisdiction and Violated the Filed Rate Doctrine

A. *The Commission's Jurisdiction over Respondents' Rates Is Exclusive*

The regulation of rates for the sale of natural gas for resale in interstate commerce by producers of natural gas (here Respondents) was vested by Congress exclusively in the Commission under the *Natural Gas Act.* This proposition is well-established judicially and is not open to debate. *Colorado Interstate Gas Co.* v. *FPC,* 324 U.S. 581 (1945); *Phillips Petroleum Co.* v. *Wisconsin, supra; Natural Gas Pipeline Co.* v. *Panoma,* 349 U.S. 44 (1955); *FPC* v. *Oklahoma Corpora-*

tion Commission, 362 F. Supp. 522 (W.D. Okla. 1973), *aff'd.,* 415 U.S. 961 (1974).

In the *Panoma* case, *supra,* this Court, in a *per curiam* opinion, struck down an attempt by the State of Oklahoma to fix a price for natural gas that was sold in interstate commerce, saying (349 U.S. at 44):

> "In these cases Oklahoma has attempted to fix a minimum price to be paid for natural gas, after its production and gathering has ended, by a company which transports the gas for resale in interstate commerce. We held in *Phillips Petroleum Co.* v. *Wisconsin,* 347 US 672, 98 Led 1035, 74 SCt 794, that such a sale and transportation cannot be regulated by a state but are subject to the exclusive regulation of the Federal Power Commission. The *Phillips* case, therefore, controls this one."

Similarly in *Oklahoma Corporation Commission, supra,* the district court there found that orders of the Oklahoma Commission relating to the wellhead price of natural gas "conflict[ed] with the jurisdiction of the Federal Power Commission under the Natural Gas Act." 362 F.Supp. at 537. The court concluded, citing *Panoma, supra,* 362 F.Supp. at 538:

> "The State has no authority, either directly or indirectly, to fix the prices at which natural gas is sold in interstate commerce."

The Fifth Circuit Court of Appeals has addressed the problem of a contract change in the same context of a "favored nation" provision in *Mississippi Power & Light Co.* v. *Memphis Natural Gas Co.,* 162 F.2d 388, 390 (5th Cir. 1947), *cert. denied,* 332 U.S. 770 (1947):

> "Rate-making is a legislative function that the courts will not interfere with, at least until the Commission has exercised the function. To give effect to the 'favored nation' clause would operate

to transfer the legislative function of rate-making from the Commission to the courts."

In *Natural Gas Pipeline Co.* v. *Harrington,* 246 F.2d 915, 918 (5th Cir. 1957), the same court passed on a claim by the pipeline for reparations because of sums paid to a producer under an invalid minimum price order of the Oklahoma State Corporation Commission:

> "Nor does any court possess such power for the purpose of fixing retroactively a just, reasonable, and lawful rate. Here the parties themselves had fixed the rate to be charged by their solemn and binding contract, and that contract rate could be changed only by the Federal Power Commission . . . ."

In the present case, the court below usurped the Commission's exclusive rate jurisdiction by awarding Respondents an increase in rates on the theory that the favored nation provision of the Rate Schedule between Respondents and Arkla had been activated and that Respondents were entitled to the increase without having to comply with the rate-change filing requirements of Section 4(d) of the *Natural Gas Act* and the Commission's Regulations thereunder (18 C.F.R. Section 154.63). The court below accomplished all this (i) without any determination by the Commission that the favored nation provision had, indeed, been activated; (ii) without consideration of all of the factors that must be considered under the terms of the contract to determine activation of the provision; (iii) without any determination that the increase in rates was just and reasonable and did not exceed the Commission's area or ceiling rates; and (iv) without any determination by the Commission that Respondents had complied with the filing requirements of the *Act* and Regulations before an increase in rates could be made effective.

The court below sought to justify this usurpation of the Commission's exclusive rate jurisdiction on the ground that the court was providing only for the recovery of damages arising from a breach of contract. By labeling the increased rate as damages, the court below "cannot separate what Congress has joined together." *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.,* 341 U.S. 246, 251 (1951).

The effort of the court below to label the judgment as damages for breach of contract will not stand scrutiny. In determining the damages the court below found it necessary (i) to rule that Respondents should be considered as having fulfilled the filing requirements of Section 4(d) of the *Natural Gas Act,* which are a prerequisite to lawful collection of an increase in rates (J.A. 60), and (ii) to find that the increased rate established by the court to assess damages would have been allowed by the Commission if the Respondents had filed the rate increase with the Commission (J.A. 62). These findings disclose that the establishment of rates under the *Natural Gas Act* was at the heart of the matter.[11]

The inefficacy of the label "damages" when, in fact, rates are at issue, has been addressed by the courts. *Interstate Natural Gas Co.* v. *Southern California Gas*

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[11] In finding that Respondents should be considered as having fulfilled the filing requirements of the Act, the court below relied on the Civil Code of Louisiana. Reliance on state law is unavailing (*infra,* pp. 23-25, 38-42). The Commission has exclusive jurisdiction over the rate increase filing requirements, and these paramount federal regulatory requirements cannot be undone by state law. *Ashland Oil & Refining Co.* v. *FPC,* 421 F.2d 17, 20 (6th Cir. 1970). Only the Commission can determine whether filing requirements under the *Act* have been fulfilled. In *Ashland* the Commission ruled that increased rates could not be collected because the filing requirements of Section 4(d) had not been met. The Sixth Circuit affirmed.

Co., 102 F.Supp. 685 (S.D. Ca. 1952); *Atlantic Richfield Co.* v. *Northern Natural Gas Co.,* No. CA-3-1548-G (N.D. Texas, filed December 1, 1977), *appeal docketed,* No. 78-1112 (5th Cir. 1978).[12]

In *Interstate,* the court said (102 F.Supp. at 688):

> "[T]he plaintiff cannot make its assault on a matter said not to be within the jurisdiction of the Commission, when adjudication must turn on matters which are within its jurisdiction. *The plaintiff cannot show damage save by showing that the Commission would approve some rate structure and some practice other than that presently existing.*" [Italics in original.]

So, here, too, the Respondents cannot show damage save by showing, as the court below recognized, that the Commission would have approved a rate structure other than the effective rate structure on file with the Commission.

In *Atlantic Richfield,* the federal district court was confronted with a fact situation essentially identical to that in the present case. The court, in deciding that it could not enforce escalation which had not been filed, said (App. 22-23a):

> "The courts do not have jurisdiction to determine a 'just and reasonable' rate for the sale of this gas. That jurisdictional anemia cannot be avoided by changing the label of 'just and reasonable' to damages for breach of contract. Only the FPC can determine the price paid for this gas. Both judicial and private price determination are thus foreclosed.

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[12] The *Atlantic Richfield* case is on appeal to the Fifth Circuit. That Court has stayed proceedings in the case pending the outcome of the present case. The decision of the district court and the Fifth Circuit's order are included in the appendix to this brief (App. 19a, 26a).

"Arco argues that this court can entertain this claim for recovery of the difference in value between what Arco was promised by Northern and what it received . . . . Arco argues that any opportunity to seek the FPC's approval was foreclosed by Northern's failure to notify Arco that it was paying a higher rate, a failure which Arco contends breached an obligation arising by implication from Northern's direct promise to pay a higher rate.

"Stating the contention takes one a long way toward its answer. Regardless of the label placed upon its claim, the result Arco seeks is a higher rate from Northern to Arco—without the FPC's approval. That conclusion is not altered by the FPC's area rate determination for the Permian Basin. That approved rate does increase the likelihood that the FPC, if requested, would have approved a higher rate paid by Northern to Arco, but it does not weaken the conclusion that, stripped of labels, Arco seeks a retroactive increase in rates, judicially promulgated."

The Commission in an order issued November 5, 1980 (see Supplemental Memorandum for the United States and the Federal Energy Regulatory Commission as *Amici Curiae,* on petition for *certiorari,* filed in this case in response to the Court's invitation), denied Respondents' petition for waiver of the filing requirements of Section 4(d). Respondents relied on *Cities Service Gas Co.* v. *FPC,* 535 F.2d 1278 (D.C. Cir. 1976). Distinguishing the present case from the *Cities Service* case, the Commission rejected Respondents' contention that no waiver was required because damages, not rates, were involved, saying (Supp. Memo., App. 11a):

"Unlike the instant case, the damages awarded in *Cities Service* did not constitute additional monies

reflecting a putative increase in the price at which gas had been sold in past transactions.[15]

"[15] Put another way, the award of damages in *Cities Service* did not consist of the difference between the Commission-determined just and reasonable rate for Western's sales to Cities Service and an alternative price for the same gas sold and bought by the same parties, based upon an assumption that the Commission somehow would have found the alternative price, rather than the filed rate, to be just and reasonable.

* * * *

"By contrast, in the instant case the Louisiana courts have, in effect, determined a rate that, in their view, should have been the just and reasonable rate—a determination that is within this Commission's *exclusive* jurisdiction. *See Montana-Dakota, supra.* The *Cities Service* decision (535 F.2d at 1287) lists a number of other factors, in addition to the price of the gas as sold to Western, that the Oklahoma court took into account in determining damages. In the instant case, there are no factors other than the difference between the filed rate and the rate the Louisiana courts thought appropriate under the contract."

The conclusion is inescapable that the court below usurped the Commission's exclusive jurisdiction over Respondents' rate to Arkla.

B. The Filed Rate Doctrine Was Violated

It is also well-established judicially that a natural gas company can claim no rate as a legal right that is other than the filed rate and that not even a court can authorize commerce in the commodity on other terms. *Montana-Dakota Utilities, supra,* 341 U.S. at 251. This is the filed rate doctrine.

In *Montana-Dakota Utilities,* this Court, concluding that courts do not possess jurisdiction to award damages that are, in truth, rates established by the court

rather than the Commission, explained (341 U.S. at 250-52):

> "Petitioner gives its case a differ [sic] cast by alleging that . . . its predecessor was deprived of its independence and power to resort to its administrative remedy. But the problem is whether it is open to the courts to determine what the reasonable rates during the past should have been. The petitioner, in contending that they are so empowered, and the District Court, in undertaking to exercise that power, both regard reasonableness as a justiciable legal right rather than a criterion for administrative application in determining a lawful rate. Statutory reasonableness is an abstract quality represented by an area rather than a pinpoint. It allows a substantial spread between what is unreasonable because too low and what is unreasonable because too high. To reduce the abstract concept of reasonableness to concrete expression in dollars and cents is the function of the Commission. It is not the disembodied 'reasonableness' but that standard when embodied in a rate which the Commission accepts or determines that governs the rights of buyer and seller. A court may think a different level more reasonable. But the prescription of the statute is a standard for the Commission to apply and, independently of the Commission action, creates no right which courts may enforce. Petitioner cannot separate what Congress has joined together. *It cannot litigate in a judicial forum its general right to a reasonable rate, ignoring the qualification that it shall be made specific only by exercise of the Commission's judgment, in which there is some considerable element of discretion. It can claim no rate as a legal right that is other than the filed rate, whether fixed or merely accepted by the Commission, and not even a court can authorize commerce in the commodity on other terms. We hold that the right to a reasonable rate is the right to the rate which the Commission files or fixes, and that, except for review of the Commission's orders, the courts can*

> *assume no right to a different one on the ground that, in its opinion, it is the only or the more reasonable.*" [Italics added.]

In its order of November 5, 1980, denying Respondents' request for waiver of the rate-change filing requirements of the *Natural Gas Act,* referred to above, pp. 22-23, *supra,* the Commission discussed the filed rate doctrine (Supp. Memo., App. 8a):

> "The filed rate doctrine has at least two aspects and policy bases, both of which are pertinent here. The first is the need for certainty as to the rates and other terms governing a regulated transaction. The Congress lodged exclusive jurisdiction in this agency to regulate sales of natural gas in interstate commerce, and provided in Section 4(c) of the Natural Gas Act that rates and charges for such sales be kept on file with this Commission. Section 4(d) provides that rates for such sales may not be changed without thirty days' notice to the Commission. These provisions have the effect of giving certainty to both buyers and sellers of natural gas in the interstate market, since only the rate filed with the Commission may be charged.
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> "A second aspect to the filed rate doctrine is that it ensures that the rates charged for natural gas in interstate commerce are, in the words of Section 4(a) of the Natural Gas Act, 'just and reasonable'. As the courts have repeatedly held, the determination of a just and reasonable rate is a matter requiring expert judgment, and the statute gives the Commission 'exclusive powers . . . to determine what those rates are to be.' "

The decision of the Supreme Court of Louisiana clearly violated the filed rate doctrine in relieving Respondents of compliance with the rate-change filing requirements of Section 4(d) of the Act and in establishing a rate for Respondents' sales other than the filed rate in derogation of the Commission's exclusive rate jurisdiction.

II. The Louisiana Courts' Decisions Wrongfully Intrude on the Commission's Primary Jurisdiction and Are Inconsistent With Applicable Regulatory Policy and Controlling Federal Law

A. *The Doctrine of Primary Jurisdiction Applies to this Case*

The fountainhead from which the entire primary jurisdiction doctrine flows is *Texas & Pacific R. Co.* v. *Abilene Cotton Oil Co.,* 204 U.S. 426 (1907). In that case, the oil company sued the railway to recover charges paid in accordance with the rate on file with the Interstate Commerce Commission. The court acknowledged that at common law an action could have been maintained to recover the charges, but ruled that "a shipper seeking reparation [or an increase in rates] . . . must, under the act to regulate commerce, primarily invoke redress through the Interstate Commerce Commission, which body alone is vested with power originally to entertain proceedings for the alteration of an established schedule." 204 U.S. at 448. The rationale justifying this doctrine was described as follows, 204 U.S. at 441:

> "[T]he existence of such a power in the courts, independent of prior action by the Commission, would lead to . . . the enforcement of one rate in one jurisdiction and a different one in another, would destroy the prohibitions against preferences and discrimination, and afford, moreover, a ready means by which . . . the wrongs which the statute was intended to remedy could be successfully inflicted."

United States v. *Western Pacific Railroad Co.,* 352 U.S. 59 (1956), is an especially instructive application of the doctrine of primary jurisdiction in terms of the instant controversy. This case established additional grounds for the application of the doctrine, namely, the special technical competence and expertise of an administrative agency and the need for uniform policy

with respect to the subject matter of regulation. The questions there were whether the Interstate Commerce Commission should first rule upon (i) the construction of a tariff and (ii) the reasonableness of the tariff as applied. The answer to each question the Court said, "depends on whether the question raises issues of [regulatory] policy which ought to be considered by the Commission in the interests of a uniform and expert administration of the regulatory scheme laid down by that Act." 352 U.S. at 65. The Court found that a determination of whether a higher rate should apply involves an inquiry into the reasons for the higher rate, and that familiarity with such reasons "is possessed not by the courts but by the agency which had the exclusive power to pass on the rate in the first instance." 352 U.S. at 67.

This Court has consistently held that matters involving the interpretation of a tariff or rate schedule in these circumstances should be decided by the regulatory agency in the first instance. *Texas and Pacific Ry.* v. *American Tie and Timber Co.,* 234 U.S. 138 (1914); *Far East Conference* v. *United States,* 342 U.S. 570 (1952); *United States Navigation Co.* v. *Cunard Steamship Co.,* 284 U.S. 474 (1932); *Port of Boston Main Terminal Association* v. *Rederiaktiebolaget Transatlantic,* 400 U.S. 62 (1970); *San Diego Bldg. Trades Council* v. *Garmon,* 359 U.S. 236 (1959). See also *Trans-Pacific Airlines* v. *Hawaiian Airlines,* 174 F.2d 63, 66 (9th Cir. 1949):

> "[W]here uniformity of interpretation of rules and consistency in application, in view of an overall policy, is compelled by the legislative mandate . . . [t]hen . . . there [is] not only a commitment of primary, but likewise of exclusive, jurisdiction to the administrative [body], and exhaustion of the remedies is mandatory." [Citation omitted.]

Similarly, in *San Diego Bldg. Trades Council* v. *Garmon, supra,* this Court was faced with a state court action awarding damages with respect to activities within the scope of another federal regulatory agency —the National Labor Relations Board. Although the case did not involve the interpretation of a rate schedule, the Court did explain why deference should be shown to the regulatory agency having plenary jurisdiction over an area of commerce. The Court stated, 359 U.S. at 243-44:

> " '*Congress did not merely lay down a substantive rule of law to be enforced by any tribunal competent to apply law generally to the parties.* It went on to confide primary interpretation and application of its rules to a specific and specially constituted tribunal and prescribed a particular procedure for investigation, complaint and notice, and hearing and decision, including judicial relief pending a final administrative order.' [Citation omitted; italics added.]
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> * * * *
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> "*Administration is more than a means of regulation; administration is regulation.* We have been concerned with conflict in its broadest sense; conflict with a complex and interrelated federal scheme of law, remedy, and administration. Thus, judicial concern has necessarily focused on the nature of the activities which the States have sought to regulate, rather than on the method of regulation adopted. When the exercise of state power over a particular area of activity threatened interference with the clearly indicated policy of industrial relations, it has been judicially necessary to preclude the States from acting. [Italics added.]
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> * * * *
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> "To leave the States free to regulate conduct so plainly within the central aim of federal regulation involves too great a danger of conflict between power asserted by Congress and requirements im-

> posed by state law. Nor has it mattered whether the States have acted through laws of broad general application rather than laws specifically directed towards the governance of industrial relations. Regardless of the mode adopted, to allow the States to control which is the subject of national regulation would create potential frustration of national purposes."

The instant controversy involves the determination of matters that clearly require the exercise of special competence and expertise of the Commission. Section 8(D) of Respondents' Rate Schedule provides that in determining whether Arkla has, in fact, purchased gas from another producer from wells located in the Sligo Gas Field at a higher price than is provided to be paid for gas delivered under the Rate Schedule "due consideration shall also be given to a comparison of all other pertinent provisions of the two contracts, such as point of delivery, basis of measurement, taxes, dehydration, and delivery pressures." These factors quite obviously involve areas of special technical competence and expertise of the Commission. These areas were, in fact, completely disregarded by the court below in concluding that the royalty payments under the government lease had triggered the favored nation provision.

B. *The Doctrine of Primary Jurisdiction Applies under the Natural Gas Act where Contractual Agreements Operate as Rate Schedules*

The lower court's rejection of Petitioner's position that the questions involved in the lawsuit were within the Commission's primary jurisdiction was based upon a misunderstanding of the decision of this Court in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956). The lower court construed the Court's statements in *Mobile* that the *Natural Gas Act* evinces no purpose to abrogate private rate contracts

and to preclude parties initially to establish their contractual relationships as rendering inapplicable the doctrine of primary jurisdiction to the dispute in the lawsuit (J.A. 34).

Under the *Natural Gas Act,* although contracts are initially established by the parties through private agreement, once the contracts are filed with the Commission as rate schedules under Section 4(c) of the *Act,* as they must be if sales of natural gas for resale in interstate commerce are involved, the full panoply of the Commission's rate review authority attaches to the contract. The "paramount and exclusive" jurisdiction of the Commission over a gas sales contract on file with the Commission as a rate schedule has been judicially recognized. *Northern Natural Gas Co.* v. *State Corp. Commission,* 372 U.S. 84, 89, 92 (1963); *Appalachian Power Co.* v. *FPC,* 529 F.2d 342, 351 (D.C. Cir. 1976), *cert. denied,* 429 U.S. 816 (1976); *New England Power Co.* v. *FERC,* 571 F.2d 1213 (D.C. Cir. 1977); *Gulf States Utilities* v. *FPC,* 518 F.2d 450 (D.C. Cir. 1975); *Zachary* v. *FERC,* 621 F.2d 155 (5th Cir. 1980). See also *Carter* v. *AT&T Co.,* 365 F.2d 486, 496 (5th Cir. 1966): ". . . a tariff, required by law to be filed, it is not a mere contract. It is the law."

The Commission has regularly interpreted the contracts on file with it as rate schedules and the courts have uniformly recognized the Commission's authority to interpret contracts as an essential element of its regulation of rates. Additionally, the courts have deferred to the Commission's contract interpretation because of the Commission's expertise and competence with respect to technical matters and industry practices which are the Commission's daily fare. *United Gas Pipe Line Co.* v. *Memphis Light, Gas & Water Division,* 358 U.S. 103, 114 (1958); *Gulf States Utilities* v. *FPC, supra,* 518 F.2d at 457; *Appalachian*

Power Co. v. *FPC, supra,* 529 F.2d at 351; *Columbia Gas Transmission Corp.* v. *FPC,* 530 F.2d 1056, 1059 (D.C. Cir. 1976); *Indiana & Michigan Electric Co.* v. *FPC,* 530 F.2d 1060, 1062 (D.C. Cir. 1976); *Zachary* v. *FERC, supra,* 621 F.2d at 157, 158; *New England Power Co.* v. *FERC, supra,* 571 F.2d at 1219, n. 22; *CF Industries, Inc.* v. *Transcontinental Gas Pipe Line Corp.,* 614 F.2d 33, 36 (4th Cir. 1980); *Texas Oil & Gas Corp.* v. *Valley Gas Transmission, Inc.,* 608 F.2d 231, 234 (5th Cir. 1979). Cf. *Western Union Telegraph Co.* v. *FCC,* 541 F.2d 346, 351, 357, n. 7 (3d Cir. 1976), *cert. denied,* 429 U.S. 1092 (1977), involving statutory deference to another federal regulatory agency's interpretation, where the court noted that "[a]n attempt to initiate this proceeding in the district court would probably have resulted in a reference to the FCC under the doctrine of primary jurisdiction" because of technical or policy considerations beyond a court's ordinary competence and within the agency's particular field of expertise.

Indeed, due to the Commission's special competence, expertise and the deference accorded the Commission's interpretations in matters subject to its rate authority, even legal questions and matters that do not involve the Commission's rate authority have been referred to the Commission under the doctrine of primary jurisdiction to secure its views in the first instance. *J. M. Huber Corp.* v. *Denman,* 367 F.2d 104, 111-12 (5th Cir. 1966); *Mississippi Power & Light Co.* v. *United Gas Pipe Line Co.,* 532 F.2d 412, 417 (5th Cir. 1976); *Carter* v. *AT&T Co., supra,* 365 F.2d at 498.

In a recent decision addressing the Commission's primary jurisdiction in connection with the interpretation of indefinite pricing provisions (such as favored nation provisions) in producer sales contracts, the Commission stated that it alone has the "accumulated ex-

perience" to deal with producer contracts "in a variety of settings" under the *Natural Gas Act,* to gauge "the intent of the parties to permit prices to escalate to the highest rates allowed by law" and "to ascertain to the extent possible, what the parties intended to accomplish in the context of the regulatory environment . . . ." *Independent Oil and Gas Association of West Virginia,* Opinion No. 77, March 4, 1980.[13]

In light of the numerous court decisions granting deference to the Commission's interpretations because of its competence and expertise, which, in part, grows out of the Commission's routine address of these matters, the Commission's statement is undoubtedly correct.

C. *This Case Requires the Commission's Expertise and the Uniform Application of Regulatory Policy*

(i) *Commission Expertise and Policy as to Triggering of the Favored Nation Provision*

The principal issue in the lawsuit is whether the payment of market value royalties by Petitioner to the United States under a government lease is a "purchase from another party seller" which "triggered"

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[13] A copy of Opinion No. 77 is included in the appendix to this brief (App. 27a). Opinion No. 77 addressed the issue of contract interpretation under the *Natural Gas Policy Act of 1978 (NGPA),* 15 U.S.C. Sections 3301, *et seq.* The issue of contract authorization to collect higher rates is exactly the same under the *Natural Gas Act* and the *NGPA.* 15 U.S.C. Section 3311(b)(9). See *Order Adopting Final Regulations Amending And Clarifying Regulations Under The Natural Gas Policy Act And The Natural Gas Act,* 44 Fed. Reg. 16895, 16898 (March 20, 1979), in which the Commission held that the standard under each statute is that established by this Court in *Mobile, supra,* and in *FPC* v. *Sierra Pacific Power Co.,* 350 U.S. 332 (1956). If the decision of the court below were allowed to stand, there is little doubt that Respondents will seek to collect NGPA rates based on that court's interpretation of Respondents' Rate Schedule.

the Section 8(D) favored nation provision of Respondents' Gas Rate Schedule. The Commission has considered this precise issue on many occasions and has developed criteria that the seller claiming "triggering" of a favored nation clause must satisfy. *Shell Oil Company, et al.*, Opinion No. 382, 29 FPC 498, 499 (1963), *aff'd., Shell Oil Co.* v. *FPC,* 334 F.2d 1002 (3d Cir. 1963):

> "[I]n order for 'triggering' to occur, where (as here) the contract so provides, the producer filing the most-favored-nation rate increase must show that the other producer is the type of seller contemplated and produces in the area indicated in the contract, that the gas being purchased from the other producer is comparable gas, and that the rate being paid for it is 'higher' in fact as well as in appearance. By showing that these and any other conditions precedent (to triggering) exist, the producer filing for the escalated increase shows that his proposed increase has the 'contractual support' or consent of his purchaser; and the increased rate may be accepted for filing. *If he fails to show that these necessary conditions exist, his filing is rejected as a contractually unauthorized, unilateral rate increase.*" [Italics added.]

Additionally the Commission requires that (29 FPC at 504):

> "After establishing what rate is valid under the contract clause for the favored-nation increase, it must be shown that such rate is just and reasonable. In sum, *the validity of his filing is at all times subject to the ultimate determination of the validity of the triggering rate as well as the justness and reasonableness of the increased rate.*" [Italics added.]

See also *West Texas Gathering Co.,* 29 FPC 510 (1962), and *Morris Mizel, et al.,* 30 FPC 1103, 1104 (1963).

In *Atlantic Richfield, supra,* a case virtually identical to the case at bar, the district court held that the interpretation of a favored nation provision in an interstate sales contract should be decided by the Commission. Like the case at bar, *Atlantic Richfield* involved a favored nation provision in a producer sales contract and a suit to collect a retroactive rate increase up to the applicable ceiling rate prescribed by the Commission. The court, referring to the policy set forth in Commission Opinion No. 382 (*Shell Oil, supra*), found the exercise of Commission jurisdiction in this situation to be mandatory. Dismissing the cause of action, the court held (App. 24a):

> "Private consensual arrangements are enforceable [in this area] only by the FPC. . . . Examination of the consequences of enforcement, whether grounded in law or equity, leads to the judgment that the congressional grant to the FPC of exclusive jurisdiction deprives this court of jurisdiction over this claim."

The court, recognizing the need for uniform application of the Commission's policy regarding favored nation provisions as embodied in *Shell Oil, supra,* concluded that the application of this policy was a matter for the Commission to decide and that Commission approval of rates up to the applicable area rate "was not guaranteed" unless the producer met the burden of proof established in *Shell Oil* (App. 23a). Recognition of the Commission's primary jurisdiction to decide the contract triggering issue was viewed by the court as inseparable from the Commission's exclusive rate jurisdiction (App. 23-24a). See *Zachary* v. *FERC, supra.* The rationale of *Atlantic Richfield* applies with equal force to this case.

(ii) *Commission Expertise in the Comparison of the Rate Schedule with the Government Lease*

The analysis and comparison of the two contracts at issue—Respondents' Rate Schedule and the government lease—require a knowledge of regulatory policies and industry practices that are within the special knowledge and expertise of the Commission. The favored nation provision provides for a comparison of the price provisions of the Rate Schedule with the

> "concurrently effective higher price provisions of such subsequent contract; provided that in determining whether a given price is in fact 'higher' than the price provisions of this contract, the inquiry shall not be limited to the actual prices stipulated but due consideration shall also be given to a comparison of all other pertinent provisions of the two contracts, such as point of delivery, basis of measurement, taxes, dehydration, and delivery pressures . . . ."

In the determination of whether the price is, in fact, higher. and, if so, how much higher, the Commission would have to look to all the other provisions of the contract such as point of delivery, payment for extracted products, basis of measurement, taxes, dehydration, and delivery pressures. Additionally, Respondents have styled their claim in state court as a separate claim for "residue gas" and "extracted plant products." The Commission would then have to compare the price in the Rate Schedule for a wet stream of natural gas, *i.e.,* one containing extractable hydrocarbons, with the royalty values for residue gas and for extracted products. Respondents' claim was made by them in the court below in an effort to make the Rate Schedule and lease comparable on that score, since the lease, unlike Respondent's Rate Schedule, involves a royalty payment for residue or dry gas (*i.e.*, gas ex-

clusive of the liquefiable hydrocarbons) and a separate royalty payment for the extracted hydrocarbons.

As has been recognized by the Commission (see Brief for the United States and the Federal Energy Regulatory Commission as *Amici Curiae* in No. 79-1896, October Term, 1980, pp. 5-6), the Rate Schedule provides for the sale at the wellhead of a wet stream of gas, including all the liquefiable hydrocarbons contained therein (and the price established in the contract was fixed by the parties in recognition of that fact) (J.A. 98-99). Only condensate (oil) recovered at the well separator was excluded from the sale of the wet gas (J.A. 100-01) and the contract provided that Arkla could buy the condensate at its option on the terms specified. Respondents nevertheless claimed in the state court that the Rate Schedule provides a separate settlement for the value of the products manufactured from the liquefiable hydrocarbons contained in the gas sold and for the value of the upgraded condensate produced from their gas wells and processed in Petitioner's plant. By these claims, Respondents would unilaterally alter the contract radically. The claim presents a complicated issue of comparison which requires Commission experience and expertise.

The necessity for the exercise of the Commission's special expertise is exemplified by the state courts' decisions on this aspect of the case. Although under the Commission's regulations the same rate applies to sales of dry (residue) gas and to wet gas (gas sold with extractable liquids contained therein)[14] *Permian Basin*

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[14] The rates apply to the natural gas whether wet or dry and there is no provision for a higher rate for wet gas. Producers get the same price for wet gas as for dry gas (see Brief for the United States and the Federal Energy Regulatory Commission as *Amici Curiae* in No. 79-1896, October Term, 1980, p. 5).

Area Rate Case, 390 U.S. 747, 820 (1968); *Mobil Oil Co.* v. *FPC,* 483 F.2d 1238, 1249 (D.C. Cir. 1973); *El Paso Natural Gas Co.,* 29 FPC 1175, 1179-80 (1963), the Louisiana courts have awarded amounts to the Respondents computed on the residue gas royalty value plus an amount for extracted liquids. The result is that the total amount awarded by the courts below is more than double the area rate ceiling applicable to the gas sold with the liquids contained therein, as provided in Respondents' Rate Schedule. The state courts' decisions if allowed to stand would undermine the Commission's rate jurisdiction of producer sales at the wellhead.[15]

D. *The State Courts' Finding that the Favored Nation Provision Was Activated Is Incorrect Because It Is Inconsistent with Controlling Federal Regulatory Law*

Payment of lease royalty to the United States did not activate the favored nation provision, which was conditioned on the "purchase from another party seller," under federal regulatory law which is determinative of the triggering issue. *Northern Natural Gas Co.* v. *State Corp. Commission, supra; United Gas Improvement Co.* v. *Continental Oil Co.,* 381 U.S. 392, 400 (1965); *Textile Workers Union* v. *Lincoln Mills,* 353 U.S. 448 (1957); *Local 174* v. *Lucas Flour Co.,* 369 U.S. 95, 103 (1962). The Louisiana courts committed error in failing to recognize the paramount nature of federal regulatory law which controls the interpretation of the contract. *Id.* The court below did recognize that under prevailing state and federal regulatory law, royalty payments are considered as rent and not purchases of gas (J.A. 36):

> "We recognize that the theory of ownership and classification of lease royalty payments as rent as

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[15] This issue is included in Arkla's pending petition for *certiorari* in No. 79-1896, October Term, 1980.

> urged by defendant is in accord with the prevailing state law and federal decisions on this issue. See *Shell Petroleum Corp.* v. *Calcasieu Real Estate & O. Co.,* 185 La. 751, 170 So. 785 (1936); *Logan* v. *State Gravel Co.*, 103 So. 526 (La. 1925); *Board of Com'rs. of Caddo Levee Dist.* v. *Pure Oil Co.,* 167 La. 801, 120 So. 373 (La. 1929); *Melancon* v. *Texas Company,* 230 La. 593, 89 So.2d 135 (1956); *Mobil Oil Corporation* v. *Federal Power Commission,* 463 F.2d 256 (1971), *cert. den.* 406 U.S. 976, 92 S.Ct. 2413 (1972)."

Nevertheless, the court erroneously ignored controlling federal decisions, finding it "inappropriate" to accept the "technical and restrictive" interpretation on the term "purchase from another party seller" (J.A. 36).

(i) *Federal Regulatory Law Is Paramount*

The Commission and the courts have recognized the paramount nature of the *Natural Gas Act* over jurisdictional transactions and that federal regulatory law controls as to such transactions. *Northern Natural Gas Co.* v. *State Corp. Commission, supra; United Gas Improvement Co.* v. *Continental Oil Co., supra; Textile Workers Union* v. *Lincoln Mills, supra; Local 174* v. *Lucas Flour Co., supra.* The displacement of state law by federal regulatory law as to the interpretation of contracts on file as rate schedules regarding the triggering of a rate increase has been recognized in both court and Commission decisions. In *Superior Oil Co.* v. *El Paso Natural Gas Co.,* 377 S.W.2d 691 (Tex. Civ. App. 1964), the court was confronted with a suit for a declaratory judgment seeking an interpretation of two purchase contracts containing favored nation provisions which Superior claimed had been triggered. The court held that the resolution of these matters was "preempted" by the application of federal regulatory law.

In *Lone Star Gas Co.* v. *Howard Corp.,* 556 S.W.2d 372, 375 (Tex. Civ. App. 1977), referring to *Superior Oil Co.,* the court stated:

> "The gas sales contracts of a natural gas company dealing in interstate commerce of gas for resale are controlled by the federal Natural Gas Act, 15 U.S.C.A., Sec. 717, et seq., and are subject to the jurisdiction of and regulation of the Federal Power Commission. *Superior Oil Company* v. *El Paso Natural Gas Company,* 377 S.W.2d 691 (Tex. Civ. App. El Paso 1964, no writ); *Phillips Petroleum Co.* v. *Wisconsin,* 347 U.S. 672, 74 S.Ct. 794, 98 L.Ed. 1035 (1954)."

So, too, in *Appalachian Power Co.* v. *FPC, supra,* it was held that the Commission had "properly treated [state] law as irrelevant to interpretation of the contract" on file as a rate schedule involving a triggering issue. In that case, the Commission had rejected the rate increase on the basis of *Mobile-Sierra, supra.* Responding to an argument that state law should control the interpretation of the rate schedule triggering issue, the Commission determined as follows, 49 FPC 387, 388 (1973):

> "[S]tate law is not relevant to these wholesale rates, which are under the jurisdiction of the Federal Power Commission. . . . Since the contracts are for the sale of electric energy at wholesale in interstate commerce, they are subject to the provisions of the Federal Power Act as interpreted by the Courts. APCO's proposal amounts to an allegation that such sales can be regulated by state law, which is not the case. (*Federal Power Commission* v. *Southern California Edison Co.,* 376 U.S. 205 (1964))."

Similar to these cases, this Court has recently rejected application of state law concepts to gas dedication issues under the *Natural Gas Act.* In *California* v.

Southland Royalty Co., 436 U.S. 519, 530-31 (1978), the Court stated:

> "We conclude that the Commission acted within its statutory powers in requiring that respondents obtain permission to abandon interstate service. 'A regulatory statute such as the Natural Gas Act would be hamstrung if it were tied down to technical concepts of local law.' *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 US 392, 400, 14 L Ed 2d 466, 85 S Ct 1517 (1965). By tying the concept of dedication to local property law, respondents would cripple the authority of the Commission at a time when the need for decisive action is greatest. Guided by *Sunray* [*Mid-Continent Oil Co.* v. *FPC*, 364 U.S. 137 (1960)], we believe the structure and purposes of the Natural Gas Act require a broader view of the Commission's authority."

Also, the Tenth Circuit ruled in *Jicarilla Apache Tribe* v. *FERC*, 578 F.2d 289, 292 (10th Cir. 1978), that "state law concepts of property interests created by oil and gas leases" are inapplicable to a regulatory determination by the Commission as to the jurisdictional rates to be charged by a small producer. More recently, the Fifth Circuit in *Tenneco Oil Co.* v. *FERC*, 580 F.2d 722 (5th Cir. 1978), referred to the Commission the issue of whether certain natural gas lease-sale agreements were sales of gas in interstate commerce under federal regulatory law.

(ii) *Mobil Oil Corp.* v. *FPC Is the Controlling Rule of Federal Regulatory Law*

In *Mobil Oil Corp.* v. *FPC*, 463 F.2d 256, 262 (D.C. Cir. 1971), *cert. denied sub nom., Mobil Oil Corp.* v. *Matzen*, 406 U.S. 976 (1972), the court held, what is settled federal regulatory law, that a royalty settlement under an ordinary market value oil and gas lease

was not in fact a sale of gas in interstate commerce over which the Commission had rate jurisdiction; and that neither under the common understanding of the words used, industry parlance, economic equivalent or any other foundation, was the royalty settlement a sales transaction. In *Mobil*, the court relied heavily upon this Court's opinion in *Burnet* v. *Harmel,* 287 U.S. 103, 107 (1932):

> "[T]he statute speaks of a 'sale' and these leases would not generally be described as a 'sale' of the mineral content of the soil, using the term either in its technical sense or as it is commonly understood. Nor would the payments made by lessee to lessor generally be denominated the purchase price of the oil and gas. By virtue of the lease, the lessee acquires the privilege of exploiting the land for the production of oil and gas for a prescribed period; he may explore, drill and produce oil and gas, if found. Such operations with respect to a mine have been said to resemble a manufacturing business carried on by the use of the soil, to which the passing of title of the minerals is but an incident, rather than a sale of the land or of any interest in it or in its mineral content. *Stratton's Independence* v. *Howbert,* 231 U.S. 399, 414, 415, 58 L. ed. 285, 291, 292, 34 S.Ct. 136; see *Von Baumbach* v. *Sargent Land Co.,* 242 U.S. 503, 521, 61 L. ed. 460, 470, 37 S.Ct. 201."

That *Mobil* is the controlling rule of federal regulatory law is demonstrated in the Tenth Circuit's recent decision in *Jicarilla Apache Tribe* v. *FERC, supra.* In that case concerning the appropriate rate to be charged by a small producer, the issue involved a determination of whether the lessor's election under a lease to take its royalty payments in kind rather than in cash was "tantamount to a purchase."

Both the Commission and the court looked to *Mobil* as the controlling federal regulatory rule of law and

not as a decision limited to the scope of the Commission's jurisdiction. The court described the Commission's position as follows, 578 F.2d at 292:

> "In its brief, the FERC argues that its ruling is supported by *Mobil* .... That case held that lessors, royalty owners were not engaged in 'sales' of natural gas merely by accepting royalty payments pursuant to their leases. The FERC argues that this conclusion is correct because the entire ownership of the gas produced under the lease is in the lessee." [Footnote omitted.]

The court also referred to *Mobil* in reaching its conclusion, stating, *Id.*:

> "The conclusion in *Mobil Oil* that royalty owners are not sellers of natural gas was not based on any concept of ownership or title, however. See 463 F.2d at 259. The court found, rather, that a royalty owner was not a 'seller' in any commonly understood sense of that term. Our decision that the Tribe is not a purchaser of its royalty gas is based on much the same reasoning."

See also *Morris Mizel, et al., supra,* where the Commission held that a lease (farmout) agreement was not a "purchase" so as to activate a favored nation provision, relying on the meaning commonly attributed to the word "purchase" in the industry. 30 FPC at 1104.

The Louisiana courts erred in not following the controlling federal regulatory law set forth in *Mobil.*

(iii) *The Louisiana Courts' Interpretation of the Favored Nation Provision Is Incorrect for Other Reasons*

The sole ground for the interpretation of the favored nation provision adopted by the Louisiana courts was that the contract should be interpreted broadly so as

to favor the seller (J.A. 37). This interpretation is inconsistent with the dominant price reducing purpose of the *Natural Gas Act. Phillips Petroleum, supra.* This aspect of the decision illustrates another reason why the Commission should determine the meaning and legal effect of contracts for the sale of natural gas subject to the Commission's jurisdiction. This Court determined in *United Gas Improvement Co., supra,* that the dominant price reducing purpose of the *Natural Gas Act* was a proper factor for the Commission to take into account in the regulatory setting under that statute. 381 U.S. at 402. The rationale of the Louisiana courts' interpretation of the contract is diametrically opposite to the purposes of the *Natural Gas Act* and rate regulation.

The decision is also at odds with the plain terms of the agreement itself. A reading of the contract on file as Respondents' Rate Schedule shows that the courts' interpretation of the favored nation provision does not square with the language of the agreement which discloses a careful distinction between a "purchase from another party seller" and a "lease" transaction involving a royalty payment.

Section 11, for example, entitled, "Royalty Settlements," specifically distinguishes between "seller" and royalty owners in that it requires seller to "pay all royalty payments and other production payments, as provided in its leases and assignments thereof, for all production delivered hereunder." In applying this section, it would be impossible to say that any person in his or her capacity as a royalty owner could be considered as a seller. Respondents have never even attempted to reconcile this section with their interpretation of the contract (J.A. 103). The contract is replete with distinctions between "party sellers" and "royalty

owners" [J.A. 87 (preamble); J.A. 88 [Section 1(B) (3)]; J.A. 89 [Sections 2(B) and (C)]; J.A. 103 (Section 12); J.A. 114 (Section IV); J.A. 115 (Sections V and VI); and J.A. 119 (Ex. "A")]. The distinction drawn in the Rate Schedule between a party seller and royalty owner strikes hard at the lower courts' construction of the United States government as a seller under the lease.[16]

III. The Louisiana Courts Erred in Their Determination of the Small Producer Status of Respondents Under the *Natural Gas Act*

The Louisiana courts erred (i) in determining which of the 15 independent producers who are Respondents herein are "small producers," and (ii) in determining that the small producer exemption from certain rate filing requirements removed the cause of action from the Commission's primary and exclusive jurisdiction under the *Natural Gas Act.*

The Louisiana courts wrongfully interpreted the Commission's regulations regarding small producers (18 C.F.R. Section 157.40)[17] as permitting the courts to award a retroactive rate increase in the guise of damages during the period that Respondents were alleged to be small producers. The Commission's primary and exclusive jurisdiction extends to small producers. *Phillips Petroleum Co.* v. *Wisconsin, supra; FPC* v. *Texaco, Inc.,* 417 U.S. 380 (1974); *Jicarilla Apache Tribe* v.

[16] The Louisiana courts' holding that a royalty settlement triggered the favored nation provision in this case was the subject of a critical review in a recent *Louisiana Law Review* note—Martin, *The Work of the Louisiana Appellate Courts for the 1978-1979 Term—Mineral Rights,* 40 La.L.Rev. 588, 601 (1980). A copy of the article is included in the appendix to this brief (App. 71a).

[17] A copy of 18 C.F.R. Section 157.40 is included in the appendix to this brief (App. 13a).

FERC, supra. Small producers are subject to the Commission's exclusive rate regulation under the *Natural Gas Act. Id.* The Commission recently held in *Arapahoe Production Co.* v. *Panhandle Producing Co.,* "Order Granting Relief," Docket No. CI78-705 (April 13, 1979), as follows: [18]

> "Since this is a matter of the regulation of small producers, under *Ashland Oil & Refining Co.* v. *F.P.C.,* 421 F.2d 17 (6th Cir. 1970) the Commission has the authority to proceed regardless of the existence of the proceeding in the state court."

Similarly, small producer contract disputes fall within the Commission's primary jurisdiction. *Zachary* v. *FERC, supra; Jicarilla Apache Tribe, supra.* As the Fifth Circuit ruled in *Zachary,* because "[t]he primary impact of the Commission's decision [on the issue of contract interpretation] is upon the rate at which [producers] can sell their gas in interstate commerce, [it is] a matter within its jurisdiction." 621 F.2d at 158. In its *Amendment and Clarification of the Commission's Interim Regulations Implementing the Natural Gas Policy Act of 1978 and Regulations under the Natural Gas Act; Order on Rehearing of Order No. 23-B,* 44 Fed. Reg. 48174, 48175 (August 17, 1979), the Commission held that:

> "There is no basis for treating small producer contracts differently than other contracts for purposes of determining whether there is a contractual authority to charge and collect a maximum lawful price . . . ." [19]

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[18] A copy is included in the appendix to this brief (App. 63a).

[19] The reference to maximum lawful price is a reference to *NGPA* rates. As explained *supra,* at note 13, the issue of contract interpretation is exactly the same under the *Natural Gas Act* and the *NGPA*.

With regard to the issue as to which of the 15 Respondents are small producers and as such need not comply with the rate-change filing requirements of Section 4(d) of the *Natural Gas Act,* the Louisiana courts erred in determining that those Respondents who do not hold small producer certificates issued by the Commission are nonetheless entitled to exemption status. The Louisiana District Court stated the proposition as follows (J.A. 18-19):

> "Four of the [Respondents], herein, Frank J. Hall, [Mrs.] Virgil J. Hall,[20] James A. Noe and S. G. Myers received Small Producers Certificates effective October, 1972 . . . ."

One other Respondent, W. E. Hall, Jr., received a small producer certificate effective October, 1972 (J.A. 186). None of the other 10 Respondents has been issued a small producer certificate by the Commission (J.A. 186). Nevertheless, the Louisiana courts extended to the other 10 Respondents the benefits of small producer status. This determination is inconsistent with this Court's decision in *Texaco, supra,* and is based upon an incorrect and impermissible interpretation of the Commission's small producer regulations. Respondents cannot be accorded small producer status without having been found to be qualifying producers under the small producer regulations. Permitting producers to collect higher rates when they have not qualified for higher rates under the Commission's small producer regulations or otherwise complied with the *Natural Gas Act* rate regulation is inconsistent with *Texaco, supra.*

The Commission's small producer regulations provide for the issuance of a certificate to qualifying producers of natural gas. A small producer is generally de-

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[20] Mrs. Virgil J. Hall is also known as Mrs. W. E. Hall, Sr.

fined as an independent producer whose sales of natural gas, together with affiliated producing interests, do not exceed a specified production quantity during the calendar year. Having applied for and obtained a small producer certificate, the producer is not required to comply with the filing requirements of Section 4(d) of the *Natural Gas Act*. The exemption from the rate-change filing requirements applies only to "small producer sales."

While the Louisiana District Court's determination of the small producer issue was based on its own interpretation of the Commission's regulation (J.A. 18-19), on appeal the Louisiana Court of Appeal affirmed the lower court, apparently relying in part on a Commission order in Docket No. RI76-28 (J.A. 40). The Louisiana Court of Appeal held that "[s]everal of the [Respondents] obtained certificates as small producers in October 1972, and the certificates issued to those parties were made effective to all [Respondents] in this action by order of the FPC" (J.A. 40). The Commission's order is pending review by the United States Court of Appeals for the District of Columbia Circuit in *Arkansas Louisiana Gas Co.* v. *FERC,* Nos. 77-1146 and 79-2068.[21]

As Petitioner has argued before the D.C. Circuit Court of Appeals, the Commission's order regarding the small producer status of Respondents violates its own regulations and contravenes the holding of *Texaco, supra.* The Commission's order unfortunately is not a model of clarity (J.A. 185-87). It can be read either as a ruling that (i) each of the 15 Respondents is a small producer because they are listed in an exhibit

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[21] Petitioner and the Commission have agreed to hold the D.C. Circuit Court of Appeals review proceeding in abeyance pending decision in this case.

to the certificate applications filed by the 5 Respondents to whom certificates were issued, or that (ii) only 5 Respondents are small producers but that the other 10 Respondents are exempt from the filing requirements because their sales are "small producer sales" under 18 C.F.R. Section 157.40(a)(3).

A determination that the 10 Respondents who do not have small producer certificates were certificated because they were included in a list in an exhibit to the application flies in the face of the regulations which limit the exemption to "small producers certificated hereunder." 18 C.F.R. Section 157.40(c). The applications filed by the 5 Respondents holding certificates provided the information regarding qualifications required of small producer applicants only for them (J.A. 185-87). Since the information regarding qualification as a small producer is required under the regulations and because meeting the qualifications is a prerequisite to certification, the 10 Respondents for whom no such information was supplied could not have been issued certificates as co-applicants. Cf. *Highland Resources, Inc.* v. *FPC,* 537 F.2d 1336 (5th Cir. 1976).

As for the other basis for holding that the Respondents who do not have small producer certificates are exempt from rate increase filing requirements, namely, that their sales qualify as "small producer sales" under 18 C.F.R. Section 157.40(a)(3), that holding would also be erroneous. There are three categories of small producer sales in 18 C.F.R. Section 157.40(a)(3). The non-certificated Respondents do not qualify for two of them because those categories apply only to producers who have applied for and received small producer cer-

tificates. The remaining category, 18 C.F.R. Section 157.40(a)(3)(ii), applies to sales made "under a small producer contract" if the producers not qualifying as small producers have interests which in the aggregate are "no greater than 12½ percent."

Since the 10 Respondents who have not obtained small producer certificates are producers whose interests in the aggregate are greater than 12½ percent (J.A. 185-87; R. Ex. P-322A-H), and their sales are not made "under a small producer contract"[22] as required by the regulations, these Respondents cannot obtain the benefits of small producer status and are not exempt from the rate increase filing requirements of the *Natural Gas Act.*

To hold, as the Louisiana courts have held, and the Commission determined in its ambiguous ruling, that the other 10 Respondents possess a small producer exemption, contravenes *Texaco, supra,* wherein it was held that reduced regulation of small producers would be permissible if it were effectively controlled by the Commission. If the Louisiana court's decision that the favored nation provision was triggered by the royalty payments and Respondents are entitled to increased rates is upheld, the 10 Respondents who have not qualified as small producers would collect higher rates set by the court below without a proper regulatory determination that they are entitled to collect such higher rates.

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[22] The contract is a large producer contract, D. B. McConnell Rate Schedule No. 4 (R. Ex. D-22).

VII. CONCLUSION

For each and all of the foregoing reasons the judgment of the court below should be reversed and the court below directed to order dismissal of Respondents' amended petition.

Respectfully submitted,

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March 5, 1981

APPENDIX

APPENDIX TO PETITIONER'S BRIEF ON THE MERITS

CONTENTS: Page

NATURAL GAS ACT

United States Code, Title 15

§ 717c. Rates and Charges: Schedules: Suspension of New Rates

(a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful.

(b) No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from June 21, 1938) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications and services.

(d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification or service, or in any rule, regulation or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be

given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commission or gas distributing company, or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any

amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

June 21, 1938, c. 556, § 4, 52 Stat. 822; May 21, 1962, Pub.L. 87-454, 76 Stat. 72.

§ 717d. Fixing Rates and Charges; Determination of Cost of Production or Transportation

(a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are

unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

(b) The Commission upon its own motion, or upon the request of any State commission, whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transportation of natural gas by a natural-gas company in cases where the Commission has no authority to establish a rate governing the transportation or sale of such natural gas.

June 21, 1938, c. 556, § 5, 52 Stat. 823.

Federal Power Commission Regulations Under The Natural Gas Act, Code of Federal Regulations, Title 18

§ 154.92 Filing of Rate Schedules By Independent Producer.

(a) Every independent producer who on or since June 7, 1954, has engaged in the interstate transportation or sale of natural gas subject to the jurisdiction of the Commission shall on or before December 1, 1954, filed with the Commission rate schedules, as defined in § 154.93, setting forth the terms and conditions of service and all rates and charges for such transportation or sale effective on June 7, 1954. To each such rate schedule there shall be attached a statement showing actual billing for a recent month in sufficient detail to show how the billing amount is determined.

(b) Every independent producer who subsequent to the effective date of this part, proposes to initiate an interstate transportation or sale of natural gas subject to the jurisdiction of the Commission to an existing or new customer shall file with the Commission not less than 30 days nor more than 90 days prior to the date such transportation or sale is proposed to be initiated a rate schedule as defined in § 154.93, setting forth the terms and conditions of service and all rates and charges for such transportation or sale. To each such rate schedule there shall be attached a statement showing estimated sales and billing for the first month of service, in sufficient detail to show method of billing and prices used. The statement shall also give the proposed date of commencement of service. A complete copy of all material shall be furnished to each purchaser under the rate schedule. With each such filing there shall be submitted a list of parties to whom such material has been mailed.

(c) Every independent producer who transports or sells less than 100,000 Mcf annually of natural gas subject to the jurisdiction of the Commission may, in lieu of the requirements of paragraphs (a) and (b) of this section file a state-

chaser, and (4) the geographical location (field, county, and State) at which delivery is made.

(d)(1) Every independent producer seeking authority to render natural gas service previously authorized by the Commission, as successor in interest in all the properties or other rights covered by a particular rate schedule, shall file three copies of the instrument of assignment whereby the assignee acquired the properties (or rights therein) involved, along with a request that the assignor's rate schedule be redesignated as the rate schedule of the assignee. He shall also file three copies of an informational summary, in the form prescribed in § 250.8 of this chapter, for each contract of sale or transportation of gas involved in the assignment.

(2) Where the authority being sought under subparagraph (1) of this paragraph relates only to an assigned portion of the rights covered by the rate schedule of the assignor, the assignee shall file, as his rate schedule, three copies of the assignor's basic contract of sale, as amended, and of the instrument of assignment together with the informational summary required by subparagraph (1) of this paragraph.

(3) If the rate schedule of the assignor relating to the rights assigned is in effect subject to refund or if the sale is being made by the assignor under temporary authorization subject to a rate refund condition, authority to render service will be granted to the assignee only upon condition that he file assurance by way of bond or undertaking that he will refund, at such times and in such amounts to such persons as the Commission may find to be entitled thereto any portion of the rate which had been permitted to become effective pursuant to § 154.102 or the rate condition in the assignor's temporary authorization as may be found by the Commission not to be justified. Assignee's obligation to refund, in the absence of his voluntary assumption of some greater proportion of assignor's liability, shall attach as of

the effective date of the Commission's order granting the assignee a certificate or temporary certificate as the base may be unless otherwise ordered or provided.

(e) Any jurisdictional natural gas company that maintains a rate schedule on file with the Commission or makes application to have a rate schedule approved by this Commission or modifies any existing or proposed rate schedule must, in addition to the requirements of this or any other section, complete and submit Form No. 108, or applicable schedules thereof, pursuant to the direction of § 260.6 of this chapter.

[Order 174-B, 19 F.R. 8808, Dec. 23, 1954, as amended by Order 278, 29 F.R. 3699, Mar. 25, 1964; Order 556, 41 F.R. 52443, Nov. 30, 1976]

§ 154.93 Rate Schedule Defined.

For the purpose of §§ 154.92 through 154.101 "rate schedule" shall mean the basic contract and all supplements or agreements amendatory thereof, effective and applicable on and after June 7, 1954, showing the service to be provided and the rates and charges, terms, conditions, classifications, practices, rules and regulations affecting or relating to such rates or charges, applicable to the transportation of natural gas in interstate commerce or the sale of natural gas in interstate commerce for resale subject to the jurisdiction of the Commission: *Provided,* That in contracts executed on or after April 3, 1961, for the sale or transportation of natural gas subject to the jurisdiction of the Commission, any provision for a change of price other than the following provisions shall be inoperative and of no effect at law; the permissible provisions for a change in price are:

(a) Provisions that change a price in order to reimburse the seller for all or any part of the changes in production, severance, or gathering taxes levied upon the seller;

(b) Provisions that change a price to a specific amount at a definite date;

(b-1) Provisions that permit a change in price to the applicable just and reasonable area ceiling rate which has been, or which may be, prescribed by the Commission for the quality of the gas involved; and

(c) Provisions that, once in five-year contract periods during which there is no provision for a change in price to a specific amount (paragraph (b) of this section), change a price at a definite date by a price-redetermination based upon and not higher than a producer rate or producer rates which are subject to the jurisdiction of the Commission, are not in issue in suspension or certificate proceedings, and, are in the area of the price in question: *Provided further,* That any contract executed on or after April 2, 1962, containing price-changing provisions other than the permissible provisions set forth in the proviso next above shall be rejected.

[Order 174-B, 19 F.R. 8807, Dec. 23, 1954; as amended by Order 232, 26 F.R. 1983, Mar. 8, 1961; Order 232-A, 26 F.R. 2850, Apr. 6, 1961; 242 27 F.R. 1356, Feb. 14, 1962; Order 329, 31 F.R. 15485, Dec. 8, 1966]

§ 154.94 Changes In Rate Schedules.

(a) No change shall be made in any rate, charge, or service in effect on and after June 7, 1954, for the interstate transportation or sale of natural gas in interstate commerce subject to the jurisdiction of the Commission by any independent producer required to file rate schedules pursuant to § 154.92, without first filing a change in rates pursuant to section 4(d) of the Natural Gas Act and in accordance with this section.

(b) Every change in any rate schedule, rate, charge, classification or service effective or applicable to a sale

subject to the jurisdiction of the Commission as of June 7, 1954, and on file with the Commission, or required to be filed pursuant to § 154.92, or in any rate schedule, rate, charge, classification or service effective or applicable to a sale subject to the jurisdiction of the Commission initiated subsequent to June 7, 1954, on file with the Commission, or required to be filed with the Commission pursuant to § 154.92 shall be filed with the Commission in triplicate not less than 30 days nor more than 90 days prior to the date such change in rate schedule is proposed to be made effective.

(c) The operation of any provision of the rate schedule providing for future or periodic changes in the rate, charge, classification, or service after June 7, 1954, or the operation of any like provision in any initial rate schedule filed after June 7, 1954, shall constitute a change in rate schedule.

(d) Any change in any rate schedule, rate, charge, classification, or service provided in a rate schedule in effect on June 7, 1954, which by the terms of said rate schedule is to be operative after June 7, 1954 and prior to September 15, 1954, may be filed on less than thirty days' prior notice, subject nevertheless to the right of the Commission to suspend any such proposed change, if the Commission in any case shall, within thirty days after the date of filing, find it necessary to suspend such proposed change. If any such proposed change is suspended, the suspension period will begin with the designated effective date of such change.

(e) With each change in rate schedule not constituting a change in rate level by any means there shall be submitted reasons, nature and basis for the proposed change and the date upon which the change is proposed to be made effective. Changes in service such as compression, dehydration, etc., by either seller or buyer shall be considered as a change in the existing rate level.

(f) *Notice of change in rate level.* (1) An independent producer who has sold in interstate commerce 5,000,000 Mcf of gas or less annually in each year of his operations during the preceding five years and who is proposing a contractual change in rates, charges, etc., shall file the information called for in the following form:

NOTICE OF INDEPENDENT PRODUCER RATE CHANGE FILING

1. Producer

....

(Name)

....

(Address)

2. Buyer

....

(Name)

3. Location of sale ..

....

(Field) (County) (State)

4. (a) FPC gas rate schedule No. ....

(b) Basic contract date ....

5. (a) Type of increase

....

(Periodic, favored-nation, renegotiated, etc.)

(b) Contract basis

....

(Specify Contract Provision)

(c)

....

(Proposed Effective Date)

6. Rates in cents per Mcf at .... psia:
(Specify)

(a) Present effective rate:

Base rate	*Tax Reimbursement*
....	....
Other [1] *(specify separately)*	*Total rate*
....	....

(b) Proposed rate:

Base rate	*Tax Reimbursement*
....	....
Other [1] *(specify separately)*	*Total rate*
....	....

7. Statement of estimated sales volume and comparative revenues for the twelve-month period succeeding the proposed effective date (shown with volume and rates at the same psia as in Item 6):

Estimated volume (Mcf)	*Revenues at present effective rate*
....	....
Revenues at proposed rate	*Difference in revenues*
....	....

8. Average Btu content per cubic foot of the gas sold during the last twelve-month period ......; estimated for the succeeding twelve-month period ....

(Date)	(Signed)
....	....
	(Title)
	....

---

[1] Dehydration, compression, Btu adjustment, etc.

(2) An independent producer who has sold in interstate commerce more than 5,000,000 Mcf of gas annually in any year during the preceding five years and who is proposing a contractual change in rate level to a price below or equal to the applicable area price level for increased rates as set out in the Statements of General Policy No. 61-1, as amended (§ 2.56 of this chapter), shall file the information required in subparagraph (1) of this paragraph and may, at his option, submit a statement in support of the proposed change but shall, in any event, submit additional information in explanation of any pertinent circumstance not specifically required by the form.

(3) An independent producer who has sold in interstate commerce more than 5,000,000 Mcf of gas annually in any year during the preceding five years and is proposing a contractual change in rate level to a price higher than the applicable area price level for increased rates set out in the Statement of General Policy No. 61-1, as amended (§ 2.56 of this chapter), and any independent producer (regardless of the quantity of annual sales) proposing an ex parte or unilateral rate change shall file, in addition to the information required by subparagraph (1) of this paragraph, a full statement in support of the proposed change in rate.

(g) A complete copy of all material filed pursuant to this section shall be furnished to each party to the rate schedule. With each such filing there shall be submitted to the Commission a list of the parties to whom such material has been furnished.

[Order 174-B, 19 F.R. 8807, Dec. 23, 1954; as amended by Order 202, 23 F.R. 3715, May 29, 1958; Order 217, 24 F.R. 9469, Nov. 25, 1959; Order 240, 27 F.R. 252, Jan. 10, 1962]

§ 154.95 Oral Agreements.

If any rate schedule or change in a rate schedule is not in writing, its terms shall be reduced to writing and filed with the Commission. If the parties are not able to agree to the precise terms within a reasonable time, the applicant shall file, in triplicate, a statement of his understanding of the agreement, serving a copy thereof on the other parties to the agreement. Such other parties, in the latter event, may subsequently file, in triplicate, their understanding of the agreement.

[Order 174-B, 19 F.R. 8809, Dec. 23, 1954, as amended by Order 202, 23 F.R. 3716, May 29, 1958]

* * * * *

§ 157.40 Exemption of Small Producers From Certain Filing Requirements.

(a) *Definitions.* (1) A "Small Producer" is an independent producer of natural gas as defined in § 154.91 of this chapter, who is not affiliated with a natural gas pipeline company and whose total jurisdiction sales on a nationwide basis, together with such sales of "affiliated producers" are not in excess of 10,000,000 Mcf at 14.65 p.s.i.a during any calendar year. As used in this section, the term "jurisdictional sales" includes volumes of gas paid for but not taken under prepayment clauses or otherwise, and volumes of gas sold under other independent producer rate schedules in the proportion that the independent producers seeking to come within this section has an interest in such sales, but does not include sales made pursuant to percentage sales contracts.

(2) "Affiliated producers" are persons who, directly or indirectly, control, or are controlled by, or are under common control with, the applicant producer. Such control exists if the producer has the power to direct or cause the direction of, or as a matter of acual practice does direct, the

management and policies of another producer, whether such power is exercised alone or through one or more intermediary companies, or pursuant to an agreement, and whether such power or practice is established through a majority or minority ownership or voting of securities, common directors, officers or stockholders, voting trusts, holding trusts, associated companies, relationship of blood or marriage, or any other direct or indirect means. For the further purposes of this section, the term "agreement" shall not include any agreement for the operation of a natural gas producing property or a plant processing natural gas or any joint venture, partnership, nominee, or other type of agreement pertaining to the joint exploration for and development and operation of oil and gas properties, unless such agreement otherwise establishes the power of one producer to direct or cause the direction of the management and policy of another producer. Also, for the further purposes of this section, the existence of one or more directors of an applicant producer in common with another producer shall be deemed a conclusive presumption of affiliation and control.

(3) "Small producer sales" are (i) sales by a small producer of his own interests under his own contracts; (ii) sales of all interests under a small producer's contract if producers not qualifying as small producers have interests which in the aggregate are no greater than 12½ percent; and (iii) sales of a small producer's interests under another producer's contract.

(b) *Procedure for securing blanket small producer certificate.* (1) Small producers may apply for a blanket certificate to cover all existing and all future jurisdictional sales that do not raise the producer's total jurisdictional sales on a nationwide basis above 10,000,000 Mcf during any calendar year. Applications by these producers shall include the following information: (i) Total jurisdictional sales on a nationwide basis for the year preceding the ap-

plication; (ii) a list of outstanding certificates and rate schedules together with names and percentage of interest of other interest owners under such rate schedules; (iii) a list of outstanding rate schedules of others in which applicant owns an interest together with applicant's percentage of interest; and (iv) the names of all owners (stockholders, partners, joint venturers, etc.) of the applicant with an interest of 10 percent or more, their percentage of ownership in the applicant and in any other natural gas company, and any positions such owners may hold with another natural gas company.

(2) An applicant for a blanket certificate who has no outstanding certificate issued by, or rate schedule filed with, this Commission for the sale of natural gas shall include the following information in his application:

(i) A list of all contracts to sell natural gas in interstate commerce.

(ii) Source of production, total rate and the annual volume delivery obligations of the producer under each such contract, together with names and percentage of interest of other interest owners under each such contract, and

(iii) A list of owners of the applicant with an interest of 10 percent or more, their percentage of ownership in the applicant and in any other natural gas company and any position such owners may hold with another natural gas company.

(3) The application shall contain the information required by the form set out in § 250.10 of this chapter. A conformed copy shall be served upon each of the applicant's purchasers.

(c) *Rate and certificate regulation under blanket certificate.* Small producers certificated hereunder shall be authorized to make small producer sales pursuant to existing and future contracts at the following rate levels:

(1) All sales of natural gas by small producers for resale in interstate commerce made in accordance with, and under the provisions of Opinion Nos. 699, et seq., shall be made at a maximum base rate of 130 percent of the applicable base ceiling rate established by the Commission in Opinion No. 699, et seq.

(2) All sales of natural gas by small producers for resale in interstate commerce made in accordance with, and under the provisions of Opinion Nos. 749, et seq., shall be made at a maximum base rate of 35.0¢ per Mcf except as provided for below:

(i) For gas produced in the Permian Basin Area, as defined by Opinion Nos. 662 and 662-A, and sold pursuant to contracts dated on or after October 1, 1968, small producers shall be entitled to collect a maximum base rate of 40.5¢ per Mcf.

(ii) For gas produced in the Rocky Mountain Area, as defined in Section 154.109(b) of the Commission's Regulations and Opinion No. 699, et seq., small producers shall be entitled to collect a maximum base rate of 40.5¢ per Mcf. The above rates are subject to any adjustments permitted or required under the particular order of general applicability involved. Such rate may be charged and received by the small producer and paid by the purchaser, as the lawful, just and reasonable rate approved by the Commission pursuant to sections 4, 5, and 7 of the Act. However, no small producer shall be relieved from compliance with section 7(b) of the Natural Gas Act with respect to any small producer sale regulated hereunder. Rate regulation as prescribed herein shall not apply to any jurisdictional sales made by a small producer where the gas reserves relating thereto were acquired by the purchase of developed reserves in place from a large producer. Nothing done hereunder shall be recognized by the Commission as triggering any escalation clause in an existing contract involving a pro-

ducer not covered by a small producer certificate, except as provided in paragraph (f) of this section.

(3) All sales of natural gas by small producers for resale in interstate commerce that qualify for the base ceiling rate of 93 cents per Mcf set in Opinion No. 770-A shall be made at a maximum rate of 130% of that ceiling rate.

(4) All sales of natural gas by small producers for resale in interstate commerce that qualify for the base ceiling rate of $1.42 per Mcf set in Opinion No. 770 shall be made at that ceiling rate.

(d) *Duration of the exemption.* The exemption authorized hereunder shall remain in effect for each small producer until the Commission on its own motion or on application terminates such certificate because the producer no longer qualifies as a small producer or fails to comply with the terms of the exemption. Upon such termination the producer will be required to file separate certificate applications and individual rate schedules for future sales but the exemption will still be effective as to those made under contracts dated prior to such termination.

(e) [Reserved]

(f) *Filings by large producers with respect to related resales.* A large producer may file for the price specified in its related contract for the resale of any natural gas sold to it by a small producer pursuant to the exemption authorized hereunder. In determining whether to accept or suspend such a filing, we shall be guided by the rate level sought and the size of the differential between the purchase and resale price. A large producer under an area rate clause in its resale contract may file for the rate paid by it for gas purchased from a small producer as long as the rate does not exceed the just and reasonable rate prescribed in paragraph (c) of this section.

(g) *Filing of contracts and notification of abandonment.* Pipeline purchasers and large producer purchasers shall

file, within 60 days of the execution thereof, each new contract and each contract amendment dated on or after March 18, 1971, for the sale of natural gas to them by a small producer pursuant to the exemption authorized hereunder, together with an estimate of the purchase volumes and the rate to be charged for the first full year after the commencement of deliveries with respect to each new contract and each contract amendment dedicating additional natural gas, and shall notify this Commission of the cessation of deliveries made by a small producer pursuant to the exemption authorized hereunder within 60 days of such cessation.

(h) *Resale authorization for large producer.* A large producer who has filed on or after July 15, 1971, an application for a certificate of public convenience and necessity for the resale of natural gas purchased from a small producer authorized to sell such gas pursuant to the blanket certificate provisions in paragraph (c) of this section may resell such gas at any time after the filing of its certificate application pending final Commission action thereon. Any amounts collected by a large producer for resales made pursuant to this paragraph in excess of the rate finally determined to be required by the public convenience and necessity for such resales shall be subject to refund with interest at 7 percent per annum.

[Order 428, 36 F.R. 5601, Mar. 25, 1971, as amended by Order 428B, 36 F.R. 13384, July 21, 1971; Order 428-C, 37 F.R. 7591, Apr. 18, 1972; Order 428-E, 39 F.R. 26631, July 22, 1974; Opinion No. 742, 40 F.R. 41772, Sept. 9, 1975; Order 553, 41 F.R. 32213, Aug. 2, 1976; Order 553-A, 41 F.R. 40100, Sept. 17, 1976; 41 F.R. 50242, Nov. 15, 1976; 41 F.R. 56792, Dec. 30, 1976]

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

Civil Action No. CA-76-1548-G

ATLANTIC RICHFIELD COMPANY, *Plaintiff*,

v.

NORTHERN NATURAL GAS COMPANY, *Defendant*.
[Filed December 5, 1977 by Joseph McElroy, Jr., Clerk]

MEMORANDUM OPINION AND ORDER

The Parties and the Dispute

Atlantic Richfield Company (Arco) asserts a breach by defendant Northern Natural Gas Company (Northern) of a "Gas Purchase Contract" (contract). There is complete diversity of citizenship and jurisdiction under Title 28 § 1332 is not contested.

The contract was executed in 1955 by Arco's and Northern's respective predecessors in interest. By its terms, Arco sells and Northern buys gas from the "Pecos Acreage." This is a dispute over the price Northern paid for gas purchased under the contract.

Article IV, Section 3 of the contract provides:

> "If the cost per Mcf of gas purchased by Permian from any gas producer in the fields or producing horizons, that Seller is selling gas to Permian hereunder from, shall be greater than the cost per Mcf of gas purchased hereunder, Permian *will increase the price per Mcf payable to Seller* for gas delivered hereunder, currently as deliveries are made, and only

during periods in which Permian is paying such greater cost to such other producer, by an amount equal to the differences between the highest cost per Mcf paid at the time by Permian to any such gas producer and the cost per Mcf payable hereunder." (underlining supplied)

On August 7, 1973 the Federal Power Commission (FPC) established a "just and reasonable" rate for Permian Basin gas. See FPC Op. 662 August 7, 1973. On September 16, 1973 the FPC granted Phillips Petroleum Company's request for a rate increase to the newly approved level. Thereafter until April 26, 1975, Northern purchased Permian Basin gas from Phillips at the higher rate. This rate was higher than the contract rate Northern paid Arco, so Arco seeks here the difference between the amount Northern paid to Phillips and the amount Northern paid to Arco for the time period September 26, 1973 to April 26, 1975.

Northern has moved to dismiss or, alternatively, to stay upon several grounds. First, Northern argues that because the contract calls for "a sale in interstate commerce of natural gas for resale," the contract is subject to the Natural Gas Act (52 Stat. 821, as amended; 15 USCA § 717 et seq.). Northern argues that the suit would require judicial determination of what are just and reasonable rates, and that this would violate congress' grant to the FPC of exclusive jurisdiction to so determine. Second, Northern argues that Arco never requested or obtained FPC approval for an increase to the "Phillips" price; that such approval was a condition predecent to its obligations under the "favored nation" clause of the contract. Third, Northern argues that the determination of whether the favored nation clause was "triggered" by its payments to Phillips is determinable only by the FPC.

Finally, overlapping its other arguments, Northern argues that Arco has failed to exhaust its administrative remedies by first seeking relief from the FPC.

To draw the issues more finely, certain primer rules of this area of the law must be kept to mind:

(1) Congress did not grant to the FPC the authority to grant reparations. See *Montana-Dakota* v. *Pub. Serv. Co.*, 341 U.S. 246, 258 (1951):

> ". . . we think it clear that Congress did not intend either court or Commission to have the power to award reparation on the ground that a properly filed rate or charge has in fact been unreasonably high or low." *Id.*, p. 258.

See also *Socony Mobil Oil Company* v. *Brooklyn Union Gas Co.*, 299 F.2d 692, 694 (5th Cir.) cert. den. 321 U.S. 817 (1962) and *McLeron* v. *El Paso Natural Gas Company*, 357 F.Supp. 329 (S.D. Tex. 1972). Since the FPC has no authority to award money damages for a contract breach it follows that regardless of the characterization of Arco's claim, the FPC could not grant the requested relief.

(2) Arco is a "natural-gas company" under the Natural Gas Act. Section 154.92 of the FPC regulations, issued pursuant to the authority conferred by Section 4(c) of the Act, requires every "independent producer" (including area) to file with the FPC its "rate schedule" defined by Section 154.93 to be

> ". . . the basic contract and all supplements or agreements amendatory thereof, effective and applicable on and after June 7, 1954, showing . . . the rates and charges . . . applicable to the . . . sale of natural gas in interstate commerce for resale subject to the jurisdiction of the Commission. . . ."

Section 4(d) of the Natural Gas Act requires that:

> "(d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge . . . or in any . . . contract relating thereto, except after thirty days notice to the Commission and to the public. . . ."

Thus, Arco could not lawfully raise its rates to Northern without FPC approval.

Resolution of the Dispute

The courts do not have jurisdiction to determine a "just and reasonable" rate for the sale of this gas. That jurisdictional anemia cannot be avoided by changing the label of "just and reasonable" to damages for breach of contract. Only the FPC can determine the price paid for this gas. Both judicial and private price determination are thus foreclosed.

Arco argues that this court can entertain this claim for recovery of the difference in value between what Arco was promised by Northern and what it received. The underlying premise of the argument is that the difference between Arco's claim and claims commited exclusively to the FPC are consonant with the objectives of the Natural Gas Act. Arco argues that any opportunity to seek the FPC's approval was foreclosed by Northern's failure to notify Arco that it was paying a higher rate, a failure which Arco contends breached an obligation arising by implication from Northern's direct promise to pay a higher rate.

Stating the contention takes one a long way toward its answer. Regardless of the label placed upon its claim, the result Arco seeks is a higher rate from Northern to Arco—without the FPC's approval. That conclusion is not altered by the FPC's area rate determination for the Permian Basin. That approved rate does increase the likelihood that

the FPC, if requested, would have approved a higher rate paid by Northern to Arco, but it does not weaken the conclusion that, stripped of labels, Arco seeks a retroactive increase in rates, judicially promulgated.

It could be argued that recovery of damages for breach of contract would not frustrate any congressionally designed scheme of exclusive FPC control of gas pricing because the recovery for breach of contract would be measured by a rate level already approved by the FPC. Although no determination that the area rate was just and reasonable would have been required, FPC approval was not guaranteed. As stated by the FPC:

> "... in order for 'triggering" to occur, where (as here) the contract so provides, the purchaser filing the most-favored-nation rate increase must show that the other producer is the type of seller contemplated and produces in the area indicated in the contract that the gas being purchased from the other producer is comparable gas, and that the rate being paid for it is 'higher' in fact as well as appearance." FPC op. 382, pp. 1, 2.

Tolerance of this approach would weaken the requirement that FPC approval of a specific price for specific gas be obtained despite FPC approval of area prices. If Arco's argument were accepted, FPC approval of an area price would trigger contractual rights of others, enforceable in the courts, with no resort to the FPC. It becomes obvious that the regulatory body charged with the responsibility and granted the exclusive power to regulate gas prices would effectively be setting off price explosions without knowing where the charges were placed. It is the chain-effects of favored nation clauses that underline their proscription. Otherwise stated, it would be anomalous to simultaneously hold that congress has given the FPC the exclusive power to determine a just and reasonable rate

for gas but the courts may determine the gas to which the rate is applicable. Nor is this result altered by the doctrine of equitable estoppel. Private consensual arrangements are enforceable here only by the FPC. The result is not altered because the underlying obligation sought to be enforced is equitable estoppel rather than a direct covenant. Examination of the consequences of enforcement of the private arrangement, whether grounded in law or equity, leads to the judgment that the congressional grant to the FPC of exclusive jurisdiction deprives this court of jurisdiction over this claim.

For the reasons stated, Northern's Motion to Dismiss must be granted.

Signed and Entered this 1st day of December, 1977.

/s/ Patrick E. Higginbotham
Patrick E. Higginbotham
United States District Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

Civil Action No. CA-3-76-1548-G

ATLANTIC RICHFIELD COMPANY

v.

NORTHERN NATURAL GAS COMPANY
[Filed December 5, 1977 by Joseph McElroy, Jr., Clerk]

Judgment

For the reason stated in the court's order of this date, defendant's Motion to Dismiss for lack of subject matter jurisdiction is granted.

SIGNED and ENTERED this 1st day of December, 1977.

/s/ PATRICK E. HIGGINBOTHAM
Patrick E. Higginbotham
United States District Judge

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT
OFFICE OF THE CLERK

Gilbert F. Ganucheau, Clerk

December 5, 1979

To All Counsel of Record

No. 78-1112—Atlantic Richfield Company v. Northern Natural Gas Company

Dear Counsel:

Please be advised, that the opinion in the above referenced case will be withheld pending outcome of the petition for certiorari filed in the Supreme Court in Hall v. Arkansas-Louisiana Gas, 368 So.2d 984.

Very truly yours,

Gilbert F. Ganucheau, Clerk

By Richard E. Windhorst, Jr.,
Richard E. Windhorst, Jr., Chief
Judicial Support Division

REW:mlv
Messrs. James R. Coffee and
Albert D. Hoppe
Messrs. Edward Kliewer, Jr. and
Stephen R. Anderton
Mr. Patrick J. McCarthy

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Opinion No. 77

Docket Nos. RI74-188 and RI75-21

INDEPENDENT OIL AND GAS ASSOCIATION OF WEST VIRGINIA

Opinion and Order Reversing Initial Decision, Remanding and Consolidating Proceedings, Initiating Hearings, Establishing Procedures, and Granting Intervention

Issued: March 4, 1980

Producer Rates—Price Escalator Clauses

UNITED STATES OF AMERICA

FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Charles B. Curtis, Chairman; Georgiana Sheldon, Matthew Holden, Jr., and George R. Hall.

Docket Nos. RI74-188 and RI75-21

INDEPENDENT OIL AND GAS ASSOCIATION OF WEST VIRGINIA

Opinion No. 77

Opinion and Order Reversing Initial Decision, Remanding and Consolidating Proceedings, Initiating Hearings, Establishing Procedures, and Granting Intervention

(Issued March 4, 1980)

The principal issue in this proceeding is whether certain indefinite price escalator clauses (often referred to as area rate clauses) in two settlement agreements approved in 1976 by the Federal Power Commission (FPC) confer contractual authority to charge and collect the rates prescribed in the Natural Gas Policy Act of 1978 (NGPA).

The Commission has addressed this question in general terms in the Order 23 series.[1] However, this is the first actual case to come before us which presents the issue in the context of specific contractual language. For the reasons discussed below, we reverse the initial decision and remand the proceeding to the presiding administrative law

[1] See Order No. 23, Docket No. RM79-22 (March 13, 1979); Order on Rehearing of Order No. 23, Docket No. RM79-22 (May 11, 1979); Order No. 23-A, Docket No. RM-79-22 (June 12, 1979); Order No. 23-B, Docket No. RM79-22 (June 21, 1979); Order on Rehearing of Order No. 23-B, Docket No. RM79-22 (Aug. 6, 1979); and Order on Rehearing of Order No. 23-A, Docket No. RM79-22 (Aug. 13, 1979).

judge. The procedures and standards we apply in deciding this case will also be followed in other proceedings involving the question of contractual authorization to collect NGPA rates.

I.

This proceeding originated in 1974, when the Independent Oil and Gas Association of West Virginia (IOGA) filed petitions with the FPC seeking higher rates for its members and other small producers in West Virginia which sell natural gas to four interstate pipelines: Columbia Gas Transmission Corporation (Columbia), Consolidated Gas Supply Corporation (Consolidated), Carnegie Natural Gas Company (Carnegie), and Equitable Gas Company (Equitable).

In Docket No. RI74-188, which involved gas from wells commenced prior to January 1, 1973, IOGA requested rates higher than those provided in the life-of-lease contracts then in effect. After the institution by the FPC of an investigation under Section 5(a) of the Natural Gas Act, settlement discussions ensued which eventually culminated in a settlement agreement approved by the FPC on March 19, 1976. In Docket No. RI75-21, IOGA petitioned for special relief for Appalachian producers from the uniform national rate established in Opinion No. 699. The settlement reached in that proceeding, which applies to gas from wells commenced on or after January 1, 1973, was approved by the FPC on March 22, 1976.[2] Both settlements, in addition to establishing specified rates, provided for annual escalations of one cent per Mcf and for renegotiation of prices in the event of deregulation.[3]

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[2] This settlement was later interpreted by the FPC to permit collection of Opinion No. 770 rates. Order Granting Petition for Declaratory Order, Docket No. RI75-21, February 2, 1977.

[3] The settlement prices in both dockets were subsequently authorized for those small producers in West Virginia which had

Both settlements also contained price escalator clauses authorizing higher rates upon the occurrence of certain events. The issue in this case is whether those events include either Congressional enactment of the NGPA or the Commission's adoption of rules with respect to NGPA rates.[4] The two clauses, which differ from each other in substantial respects, provide as follows (significant terms underlined):

Docket No. RI74-188:

> *Area Ceiling Rate.* Notwithstanding anything to the contrary in this settlement proposal, upon the ***issuance by the Commission, or any successor governmental authority having jurisdiction hereof hereafter, of a valid order establishing a just and reasonable ceiling rate*** which would otherwise be applicable to the gas being sold hereunder if contractual authority existed for obtaining such rate, if such rate is higher than the Adjusted Price as theretofore increased pursuant to Section 4 hereof, then the price to be paid by the Buyers pursuant to the Contract after the effective date of such order for gas sold shall be equal to such ceiling rate.

Docket No. RI75-21:

> *Superseding rates.* Notwithstanding anything to the contrary in this Settlement Proposal, upon the ***issuance by the Commission, or any governmental authority having jurisdiction over the sales covered by this Settlement Proposal, of an order, decision or policy***

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not initially participated in the proceedings. Order Granting Special Relief, Docket Nos. RI74-188 and RI75-21, October 14, 1976.

[4] The need for interpreting the escalator clauses arises from the fact that, under Section 101(b)(9) of the NGPA, a contract price lower than the federal maximum lawful price established in the legislation would continue in effect and not be superseded by the federal ceiling price. See Order 23, mimeo, pp. 12-13.

establishing a rate or rates which would be applicable to the gas being sold hereunder if contractual authority existed for obtaining such rate or rates, if such rate or rates are higher than the lower of the Adjusted Prices as theretofore increased pursuant to Section 3 hereof, then the price to be paid by the Buyers to the Producers for the gas sold to the Buyers pursuant to the Contracts after the Effective Date, as defined herein, for gas sold shall not be less than such rate or rates.

On December 13, 1978, Columbia filed petitions seeking clarification of the FPC orders approving the settlement agreements. Columbia requested confirmation of its view that both area rate clauses authorized collection of NGPA rates. Following a series of motions and other pleadings by various parties, we forwarded the matter to the chief administrative law judge for resolution in accordance with Order 23-B procedures.[5] The Chief ALJ issued an order on July 19, 1979 in which he designated a presiding judge and established procedures for this proceeding, including a determination that, because there were no factual issues in dispute, the legal issues would be summarily disposed of in an initial decision. Consolidated requested reconsideration, asserting that a prehearing conference should be held in order to determine the extent to which it would be necessary to present parol evidence concerning the intent of the parties. By order dated July 26, 1979, the Chief ALJ reaffirmed his prior decision that a hearing would be unnecessary but advised Consolidated that it was not estopped from presenting whatever evidence it believed relevant in the form of written submissions.

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[5] As we explained in our order of July 13, 1979, the pleadings which had been filed by Equitable and Consolidated contesting Columbia's interpretations were treated as protests within the meaning of Order 23-B.

II.

On August 10, 1979, the presiding judge issued an initial decision in which he concluded that neither clause authorizes the collection of NGPA rates. His conclusion rests upon the following determinations:

(1) Since the pertinent contractual language is not ambiguous, it is unnecessary to consider extrinsic evidence bearing on the intent of the parties. Moreover, because the question is solely one of law, no oral hearing is required.

(2) Under the Administrative Procedure Act, as well as in common parlance, the term "order" refers to agency action and can not be construed as encompassing an Act of Congress.

(3) Similarly, Congress does not act through the "issuance" of a "decision" or "policy"; these terms also relate only to agency action.

(4) Hence, even if, as suggested in Order 23, Congress could be viewed as a "successor" to the Commission for ratemaking purposes, the phrase "successor governmental authority" as used in the Docket No. RI74-188 clause can not be interpreted as referring to Congress because that body does not perform its ratemaking function by "issuing orders".

(5) The absence of the term "successor" in the Docket No. RI75-21 clause does not indicate that Congress was intended to be included. More likely than not, the elimination of the term was based on the parties' desire to include other federal or state agencies which might have regulatory jurisdiction at some time in the future without being successors to the FPC.

(6) Neither clause covers Commission action because the Commission did not "establish" the NGPA rates. The Commission's role is ministerial; it merely implements the rates established by Congress.

(7) The parties and the Commission may not, as a matter of law, read into the settlements terms which are not there.

III.

The various parties to this proceeding[6] express widely divergent views concerning the initial decision and the proper interpretation of the area rate clauses at issue. There are three fundamentally different positions with respect to the legal effect of the two clauses.[7]

IOGA, several producer-intervenors, and Columbia seek reversal of the initial decision in its entirety. They interpret the terms of both settlements as clearly authorizing collection of NGPA prices. They also assert that the parties intended that result and argue that the presiding judge, in failing to consider such intent, did not comply with Order 23. At the other extreme, Equitable, Carnegie, Associated Gas Distributors, the Public Service Commission of the State of New York, and customer-intervenors support the judge's conclusion that neither settlement permits NGPA rates to be charged. These parties also rely on the specific terms of the agreements to support their position. Moreover, they contend that the clauses were intended to permit escalation only to rates which were cost-based and which were fixed at the conclusion of a regulatory proceeding in which all affected persons had an opportunity to participate. They claim that NGPA rates are incentive, not cost-based, prices.

An intermediate position is advanced by the staff and Consolidated, which distinguish between the two settle-

[6] Subsequent to the issuance of the initial decision, we received a number of petitions for leave to intervene and to file briefs out of time. These requests will be granted.

[7] Six positions were taken before the presiding judge, but certain parties have now modified their views.

ments. It is their view that the first settlement authorizes collection of only Section 104 inflation adjustment prices, whereas the second settlement permits all NGPA rates to be charged. The staff bases its conclusion on the fact that the phrase "just and reasonable" appears in the former clause but not in the latter. Although Section 601(b)(1)(A) of the NGPA provides that NGPA rates are deemed just and reasonable, the staff asserts that the phrase must be construed in the context of the Natural Gas Act, which was the governing statute at the time the settlements were entered into, and as so construed it reflects an intent to be limited to cost-based rates. The staff also argues that Section 104 prices are cost-based and are therefore within the scope of the phrase "just and reasonable" as used in the area rate clause in the Docket No. RI74-188 settlement agreement.

IV.

Although this is the first proceeding in which the Commission has been called upon to decide whether specific area rate clauses authorize the collection of NGPA rates, we recently had occasion to deal rather extensively with the general issue in the Order 23 series. We expressed in those orders certain views concerning the interpretation of area rate clauses which are highly relevant to the resolution of this proceeding. However, before proceeding to a decision in this case, we think it is appropriate to articulate in somewhat greater detail the principles which we will apply in resolving the question before us.

The fundamental concept underlying Order 23 is that, in determining whether a particular clause authorizes collection of NGPA rates, the Commission will endeavor to ascertain and give effect to the intent of the parties to the contract. Indeed, this conclusion led us to amend Rule 270.205(a)(2) to make it clear that intent is the controlling

factor with respect to this issue.[8] We also stated that in reaching a decision as to the parties' intent, the Commission can look beyond the contractual language itself and consider circumstances surrounding the execution of the contract.

Our conclusion that the Commission is not limited to the "four corners" of a contract in determining intent was arrived at after thorough consideration of the record developed in the rulemaking proceedings culminating in that order. The written and oral submissions in those proceedings revealed a "substantial level of agreement between most sellers and buyers as to what was generally intended when the area rate clause was executed," namely, that "the intent of the parties in agreeing to an area rate clause was to permit escalation to the highest ceiling price permitted by law." [9] In view of the record developed in the rulemaking proceedings and in light of the accumulated experience of the Commission in dealing with area rate clauses in a variety of settings, there is ample reason to believe that the intent of the parties to permit prices to escalate to the highest rates allowed by law—including statutory rates—may not, in many cases, have been fully reflected in the terms they chose. Since the words they used were a product of the then prevailing regulatory scheme under the Natural Gas Act, we must attempt to ascertain, to the extent possible, what the parties intended to accomplish in the context of that regulatory environment and to give effect to that intent in light of the changed circumstances brought

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[8] As amended, the rule provides:

> A contractual provision described in § 154.93 (b-1) (relating to area rate clauses), or similar provision, generally will be considered to constitute contractual authorization to charge and collect an NGPA rate to *the extent the parties intended to authorize charging and collection of one or more NGPA rates under the contract*. (emphasis added)

[9] Order 23, mimeo, pp. 37-38.

about by enactment of the NGPA.[10] And we are persuaded that, in many instances, the terminology employed in area rate clauses lacks the clarity which would properly warrant exclusion of extrinsic materials relevant to the question of intent.

For example, the parties may have provided in their contract for escalation to a "just and reasonable" rate. That phrase, standing alone, is subject to conflicting interpretations. It may have been used to express an intent to permit collection of the maximum legally permissible prices, since such prices were required to be just and reasonable under the governing statute then in effect and since only rates meeting that standard could be assured of being passed through by the purchaser to its customers. If that was what the parties contemplated, we do not believe their intent should be thwarted merely because they failed to foresee that the Congress would assume the ratemaking function previously delegated to the Commission and thus expressed their intent in the terminology of the Natural Gas Act. On the other hand, the parties may have referred to "just and reasonable" rates in contemplation of the methodology and procedures which have traditionally been utilized in establishing rates under the Natural Gas Act. The long-standing practice of the FPC and of this Commission has been to set those rates under a cost-based methodology and in the context of an agency proceeding in which affected parties have been afforded the opportunity to participate. If the parties to a contract meant to incorporate these traditional regulatory features into their agreement, it would be inconsistent with their intent to find that the contract authorized collection of all NGPA rates.

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[10] See *Mitchell Energy Corporation* v. *F.P.C.*, 519 F.2d 36, 41 (5th Cir. 1975), where the court said that it "must interpret the terms of the agreement of the parties as they must have understood them at the time they entered into it within the framework of the Natural Gas Act."

Under the circumstances, we conclude that unless a contract specifically includes or excludes statutory rates, it is appropriate to provide an opportunity to the parties to the contract to offer extrinsic evidence of intent.[11] In our judgment, any contract which is less than explicit about the status of statutory rates must be viewed as containing an element of ambiguity which, even under the traditional "plain meaning" rule of contract interpretation, opens the door to consideration of reliable and probative extrinsic materials bearing on the issue of intent.[12] The exclusion of such evidence would, in many cases, lead to a result which would be inconsistent with the expectations of the parties. We decline to follow that path.

The Commission will, in the first instance, look to the written expression of the intent of the parties embodied in the contract itself. Where we find, however, that the document is not free from ambiguity, we will also rely, in resolving the ambiguity, upon the following:

(1) reliable and probative extrinsic evidence of the parties' intent;

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[11] The circumstances and standards under which such an opportunity will be provided are specified below.

[12] See, for example, *Sam Rayburn Dam Electric Cooperative* v. *F.P.C.*, 515 F.2d 998, 1003 (D.C. Cir. 1975). In *Western Union Telegraph Company* v. *Federal Communications Commission*, 541 F.2d 346 (3rd Cir. 1976), the court sustained the FCC's consideration of affidavits concerning the parties' intentions in the execution of a contract. The court relied on Section 556(d) of the Administrative Procedure Act, which provides: "Any oral or documentary evidence may be received, but the agency as a matter of policy shall provide for the exclusion of irrelevant, immaterial, or unduly repetitious evidence." The court said: "The paramount issue being the real intention of the parties, . . . and the Commission having obviously concluded that an affidavit speaking to that issue was not 'irrelevant, immaterial, or unduly repetitious,' we are not in a position to gainsay that conclusion." 541 F.2d at 353. We caution parties to these proceedings, however, that the Commission will not necessarily admit addfidavits as a matter of course in these cases. See page 16, n. 21, *infra*.

(2) where the parties to the contract are in agreement, the intent which they ascribe to their area rate clause; and

(3) where the above factors are absent or inconclusive, the text of the clause as interpreted in accordance with the standards set forth below.

The relative weight which each of the above-enumerated elements will be given in a particular case will vary with the context in which a question arises. There are three discrete types of cases which we will now proceed to discuss:

(1) The parties agree on an interpretation and no third party (including Commission staff) contests it.

(2) The parties can not agree on an interpretation of the area rate clause.

(3) The parties agree but their mutual interpretation is disputed by a third party.

In the first case, we reaffirm the view expressed in Order 23 that, even where a contract does not expressly provide for the collection of statutory rates, we will generally give effect to the intent ascribed by the parties to their contractual language and permit them to rely on the area rate clause as authority for the collection of NGPA rates. Absent language in the contract which would constitute a specific exclusion of legislatively established rates, we will assume that the statements of the parties as to their intent are accurate and truthful and will accord dispositive effect to the mutual interpretation of the parties.[13]

However, if the parties themselves can not agree on the interpretation of an area rate clause, the Commission obviously can not be guided by either of their conflicting

[13] However, an opportunity to rebut this presumption will be provided if a protest submitted by a third party or the staff contains reliable and probative evidence contradicting the parties' mutual interpretation. See page 16, *infra*.

statements of intent. In such cases, the Commission must itself construe the contract. The starting point for analysis is the text of the contract. If the price escalator clause expressly permits collection of statutory or legislatively established rates, the Commission will, of course, permit sellers to charge and collect NGPA rates. Where, however, there is no such explicit reference, the Commission will allow the parties to make an offer of proof as to intent. If an offer of proof is made, the Chief ALJ (or the presiding judge, if one has been designated) will then determine how to proceed further. The judge will evaluate the offer and determine whether an evidentiary hearing should be held. If he concludes that the evidence offered would not be reliable and probative of the parties' intent, he should reject the offer and issue an initial decision by summary disposition in accordance with the interpretive standards discussed below. Likewise, if a hearing is held, only evidence determined by the judge to be reliable and probative should be admitted.

In those cases where there is no reliable and probative evidence of intent or where such evidence is inconclusive, the Commission will ascertain the intent of the parties on the basis of the text of the clause in dispute. In such situations, we will *generally* conclude that a contract containing an area or national rate clause does not authorize collection of all NGPA rates if it contains the following disqualifying terms:

(1) It refers to rates established or prescribed by an administrative body;

(2) It couples the reference to administrative action with a reference to the Natural Gas Act or the "just and reasonable" standard of that Act; and

(3) It contains no additional language which has the effect of uncoupling the link between agency action and the statutory standard of the Natural Gas Act.

If all of the above three factors are present, the Commission will interpret the contract to authorize collection of only those NGPA rates which are cost-based, namely, those provided in Sections 104 and 106(a). If these disqualifying terms are not *all* present, we would generally find that an area or national rate clause authorizes NGPA rates. Let us explain.

Where a reference to administrative action is not coupled with a reference to the Natural Gas Act or the statutory standard under that Act, the Commission will generally find that all of the NGPA rates are authorized by the price escalator clause. A contractual provision with no reference to a particular ratemaking standard would generally indicate an intent to permit prices to rise to the highest prices permitted by law. The fact that a contract refers to rates established by the Commission or by a "valid order" does not, in and of itself, signify that the parties intended to exclude rates imposed by legislative action. The Commission's ratemaking power under the Natural Gas Act was delegated to it by the Congress.[14] We will not assume, in the absence of specific language or reliable and probative evidence, that the parties intended to be bound by an agency determination but not by a mandate emanating from the source of that agency's authority. Hence, we decline to conclude that the mere transfer of the ratemaking function from the Commission to the Congress—most likely unforeseen by the parties at the time the contract was executed—should operate to defeat the intent of the parties simply because they expressed that intent in terminology which was based on the regulatory scheme then in force.[15]

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[14] See Order 23, mimeo, p. 46, n. 44.

[15] Our views on this matter are consistent with positions taken by the courts under analogous circumstances. In *City of Oglesby v. F.E.R.C.*, 610 F.2d 897 (D.C. Cir. 1979), the court accepted, without discussion, the contention of the petitioners that in pro-

Similarly, where a contract provides for escalation to "just and reasonable" rates and does not refer to agency action, we will generally conclude that all NGPA rates are contractually authorized.[16] We acknowledge that a reference to the "just and reasonable" standard is subject to differing interpretations.[17] Nevertheless, in those cases

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viding for a rate change "by order of the Illinois Commerce Commission," the parties simply meant to "advert to the command of the appropriate regulatory agency." The agreements had been executed after FPC (later FERC) jurisdiction over wholesale rates had become clear, but the language used was a carryover from earlier agreements. In light of this explanation, the court had no difficulty in substituting the federal agency for the state body referrel to in the contract, and then proceeded to discuss the contested issue before it, namely, whether the contract incorporated the state's regulatory procedures which arguably permit unilateral rate modifications. 610 F.2d at 903.

In Richmond Power & Light v. *F.P.C.*, 481 F.2d 490 (D.C. Cir. 1973), the court followed the same approach where the contract had been entered into prior to FPC jurisdiction over the agreement. The court accepted the FPC's position that the parties intended to be bound by an order of the appropriate regulatory agency, and stated that it had no quarrel in principle with interpreting the contract, in light of changed circumstances, to accomplish what the parties intended. 481 F.2d at 499.

It appears, therefore, that the courts will not invalidate a contractual provision merely on the basis of a transfer of regulatory jurisdiction. Accordingly, even where area rate clauses refer only to Commission or agency action, they should not be rendered inoperative solely because of the assumption by Congress of the ratemaking function.

[16] Such contracts are of the so-called "going rate" type which the FPC permitted in Section 154.93(b-1) of its regulations under the Natural Gas Act, provided that the "going rates" were controlled, were of general applicability, and satisfied certain other conditions. As we said in Order 23 (mimeo, p. 36), the NGPA maximum ceiling prices meet each of the criteria established by the FPC.

[17] As discussed at page 8 above, the parties' utilization of the "just and reasonable" standard is ambiguous; they may have in-

where the written agreement fails to join the reference to the "just and reasonable" standard with a reference to agency action, we think the most reasonable construction of the clause, in the absence of reliable and probative evidence of a contrary intent, is that the parties intended to permit prices to rise to the maximum rates allowed by law.[18]

However, where a contract couples a reference to administrative action with the "just and reasonable" standard of the Natural Gas Act, and there is no additional language which has the effect of uncoupling that link, we will generally conclude, absent reliable and probative evidence showing otherwise, that the parties meant to limit escalation of prices to those which are administratively established and cost-based. In these circumstances, the ambiguity inherent in the adoption of the "just and reasonable"

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tended to limit escalation to administratively established, cost-based rates. Or they may have used the phrase simply because they sought assurance that the prices collected could be passed through and because the highest legally permissible rates were required to conform to the standard of the Natural Gas Act. A different case would be presented, however, where the area rate clause refers to rates established under the Natural Gas Act. Here the parties would seem to have bound themselves to the statutory scheme, one which itself ties the "just and reasonable" standard to agency action pursuant to procedural requirements with an opportunity for judicial review. A clause which references rates under the Natural Gas Act would seem to preclude authorization of NGPA rates unless subsequent language in the contract uncouples the escalator clause from the Natural Gas Act.

[18] This view is most plainly in accord with the weight of submissions by parties to these contracts received in the Order 23 proceedings. See p. 7, *supra*. It is also worth noting here that the NGPA rates are "deemed to be just and reasonable" by the Congress and their passthrough to consumers is specifically authorized and directed unless this Commission finds that the amount paid was excessive due to fraud, abuse, or similar grounds. See Sections 601(b)(1)(A) and 601(c)(2) of the NGPA.

standard is clarified by the use of terminology binding the parties to the determinations of an administrative body. We will therefore resolve that ambiguity by interpreting the area rate clause as incorporating the traditional features of regulatory practice long associated with the establishment of rates under the Natural Gas Act, namely, the use of a cost-based methodology and the opportunity for party participation afforded by an agency proceeding. Accordingly, in such cases the Commission would not find the requisite contractual authority to charge and collect NGPA rates other than the Sections 104 and 106(a) rates.[19]

Where, however, the contract contains additional language which has the effect of dissociating the bond between administrative action and the statutory standard of the Natural Gas Act, we will generally conclude that the contract authorizes collection of all NGPA rates unless reliable and probative evidence demonstrates otherwise. Such an uncoupling could occur, for example, where a reference to the Natural Gas Act or the "just and reasonable" standard is supplemented by the phrase "or successor statutory authority" or words of similar import.

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[19] See the discussion of Section 104 and Section 106(a) rates in Order 23, mimeo, pp. 44-46, where we said that the Section 104 prices are based upon and inextricably linked to previously prescribed FPC rates, and that this is also generally true of the Section 106 price ceilings applicable to rollovers of interstate contracts. As we there explained, these prices were determined by freezing FPC rates as of April 20, 1977 and changing the escalation factors from those established by the FPC to a method which takes inflation into account. Thus, we have cost-based rates which are adjusted to keep them in constant, real April 1977 dollars. Unless the parties in a particular case can demonstrate otherwise by reliable and probative evidence, we do not believe that the mere modification of the escalation factors had the effect of bringing Section 104 and Section 106(a) rates outside the scope of what was generally contemplated by parties who intended to restrict escalation to administratively established, cost-based rates.

In this circumstance, the parties commit their contractual destiny to a change in the statutory scheme and give advance acceptance to the outcome of the legislative process.[20]

We emphasize that while the above interpretive standards constitute, in our judgment, the most reasonable constructions of ambiguous area rate clauses in the absence of other reliable indicia of intent, they are by no means the only reasonable interpretations of such clauses. Thus, for example, contractual language coupling a reference to agency action with a reference to the "just and reasonable" standard would not necessarily be inconsistent with an intent to permit collection of the highest lawful prices. When viewed in the context of the regulatory scheme in effect when the agreement was entered into, such language may well have been employed as a means of expressing an intent to allow the maximum rates permitted by law. Conversely, it would not be unreasonable to interpret a clause which refers to either administrative action or the "just and reasonable" standard without linking the two as authorizing only administratively established, cost-based rates. Accordingly, where the meaning of an ambiguous contract is clarified either by the mutually agreed upon interpretation of the parties themselves or (where the parties can not agree) by reliable and probative extrinsic evidence of the parties' intent, we will rely on those factors in determining the meaning of the clause. In short, the interpretative guidelines set forth above will be applied only where:

(1) the contract does not contain language which would constitute an explicit inclusion or exclusion of statutory rates, and is therefore ambiguous;

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[20] Likewise, if a reference to administrative action is followed by language broad enough to encompass legislative enactments, the clause would appear to indicate that the parties did not intend to be restricted to the outcome of an agency proceeding.

(2) the parties themselves are not in agreement; and

(3) reliable and probative evidence of intent is either absent or inconclusive.

It follows from the foregoing that in the third type of case enumerated above—where the parties agree but their mutual interpretation is contested by a third party—a different standard must be applied from that which pertains when the parties themselves are in disagreement. In contrast to the latter situation, where reliance on the parties' present statements of intent is necessarily precluded by their conflicting positions, we will generally presume that the mutual interpretation of the parties to a contract should be relied upon to resolve any ambiguities in the instrument. The parties to the agreement are in the best position to know what they intended. And where they agree that they contemplated the highest legally permissible rates, their statement is entitled to a presumption of validity even if the language, standing alone, lends itself to an interpretation that they envisioned administratively established, cost-based rates. Accordingly, while we consider it appropriate to afford affected third parties and their representatives the opportunity to challenge the mutual understanding of the parties to the contract, such third parties will necessarily bear a heavy burden in attempting to overcome the presumption of validity to which the interpretation of the direct parties is entitled. We conclude, therefore, that in the case of third-party protests to the collection of NGPA rates which the parties agree is contractually authorized, the Commission will find contractual authorization to collect NGPA rates unless the express terms of the contract exclude rates promulgated by statute or the protest (including any supplemental filing submitted in accordance with Rule 23-B procedures) contains reliable and probative extrinsic evidence which, if true, would specifically contradict the mutual interpretation of the parties

and be dispositive of the case.[21] If the protest contains such evidence or if the express terms of the contract exclude rates promulgated by statute, the Chief ALJ or the presiding judge would establish further proceedings.[22]

We recognize that our approach may lead to differing results in different cases even where the contractual language is identical, depending on whether the dispute involves the parties themselves or third-party protests. For example, where the parties to the contract disagree and there is no reliable and probative evidence of intent, we might interpret a particular clause under the guidelines set forth above as authorizing only Section 104 and Section 106(a) rates, whereas we would find that the same clause authorizes collection of all NGPA rates where the parties agree on that interpretation unless a third party can establish by reliable and probative evidence that the parties intended otherwise.

We see nothing wrong with that. To begin with, since we are dealing with intent, some degree of variation is to be expected; it would be surprising indeed if, in light of the reasonable alternative constructions discussed above, the parties to all contracts containing the same language had an identical intent.[23] Moreover, as previously stated, the

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[21] If such evidence takes the form of affidavits, they must aver specific factual circumstances which, if true, would contradict the parties' construction of the contract.

[22] Further proceedings may be appropriate even where the contractual language specifically excludes rates promulgated by statute and thus does not appear consistent with the parties' interpretation, since they may have engaged in a course of conduct subsequent to execution of the instrument which modified its original terms. See Order 23-B, mimeo, p. 11, n. 14.

[23] See *Arkansas Louisiana Gas Company* v. *Hall*, Docket No. RI76-28 (order issued May 18, 1979), where we pointed out that a uniform interpretation would seem to be impossible where the issue is the intent of the parties to a contract. *Id.* at 8 (mimeo). [footnote continued on page 29a]

interpretative standards which we will apply in the case of disputes between the parties to the contract do not necessarily represent the only reasonable interpretations of area rate clauses; rather, the guidelines are aids to construction where other extrinsic factors are unavailable or unreliable. Where the parties are in agreement, however, their mutual interpretation should be accepted so long as the text of the clause is reasonably susceptible to that interpretation and their position is not contradicted by reliable and probative evidence.

We observe, in this regard, that the body of contract law which has evolved under our legal system was designed essentially to resolve controversies between the parties to an agreement or their successors-in-interest. When, however, the parties reach a mutual understanding, without resort to litigation, as to the proper interpretation of a contractual provision, the construction to which they have agreed is controlling. Furthermore, even where the parties eventually have a parting of the ways and litigation ensues, the courts accord great weight to prior acts or declarations of the parties which are indicative of a previous mutually agreed upon interpretation.[24] It would appear even more

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However, notwithstanding the possible differences in the outcomes of particular cases, the Commission has primary jurisdiction over the issue of contractual authorization to charge NGPA rates under the criteria established in *Arkansas Louisiana, supra*. First, this issue is clearly of great import to our regulatory responsibilities under the NGPA. Furthermore, it is evident from the discussion above that to the extent that the circumstances of different proceedings are similar, the Commission will apply uniform standards and procedures in deciding the question of contractual authorization to charge NGPA rates.

[24] See 4 *Williston on Contracts* § 623 (3rd ed. 1961). In *United States* v. *F. D. Rich Company*, 434 F.2d 855, 859 (9th Cir. 1970), the court, relying on a prior Ninth Circuit decision in *Pekovich* v. *Coughlin*, 258 F.2d 191 (1958), said:

> *Pekovich* is closely in point. There, the court held that the writing was ambiguous and that the trial judge had to con-

appropriate to follow that approach when the parties continue to be in agreement before the decisional forum, and particularly where the interpretation of the parties is consistent with that suggested by a majority of the comments submitted in the Order 23 rulemaking proceeding.[25]

V.

We now turn to the application of the foregoing guidelines to the case before us. Although the Order 23 series applies by its terms to contracts, not settlement agreements, the Commission will apply analogous principles in interpreting the IOGA settlements. These settlements are multiparty rather than bilateral agreements, and the controversy we are called upon to decide involves not only a dispute between the sellers and the purchasers but also a disagreement among the purchasers themselves as to the meaning of the area rate clauses. In these circumstances, the Commission must treat the settlements as a case when the parties can not agree on the meaning of the contract.

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strue the meaning of the writing by recourse to the facts as developed in the evidence. There, as here, the parties agreed on the meaning of the instrument in question. The court went on to say that such being the case, the contract was enforceable as interpreted by the parties themselves.

[25] As we pointed out in Order 23 (mimeo, pp. 13-14), the responsibility of the Commission to determine whether contractual authority exists for collection of NGPA rates is based upon the doctrine announced by the Supreme Court in the *Mobile* and *Sierra* cases, namely, that rate filings inconsistent with contractual obligations are invalid. Those two cases involved disputes between the parties to the applicable contracts, not third-party protests to the collection of rates which the parties agreed were contractually authorized. See *United Gas Pipeline Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1950); *F.P.C.* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1950).

The presiding judge concluded that neither of the area rate clauses in the two settlements [26] authorizes collection of NGPA rates. He held that the language in both clauses unambiguously refers only to administrative action as the event triggering higher rates; hence, Congressional enactment of the NGPA could not have that effect. He further ruled that since the Commission's function with respect to NGPA rates is ministerial in nature, the Commission did not "establish" those rates within the meaning of the settlement clauses. In addressing IOGA's contention that the parties intended the rate to rise to whatever level sanctioned or enacted by the federal government, the judge responded: "If this was the intent of the parties, though, it was not embodied in the unambiguous word 'order'." [27]

For the presiding judge, the text of the clauses was not only the starting point for analysis, but the end point as well. In this he erred. For the reasons expressed above, the fact that a price escalator clause speaks only of rates established by agency action does not necessarily mean that the parties intended to exclude statutory rates. The judge failed to recognize that an intent to permit escalation to the maximum lawful rates may well have been embodied in terminology that was a product of the then prevailing regulatory setting. The parties should have been provided the opportunity to make offers of proof of reliable and probative evidence of intent unless the area rate clauses were found to contain language which constitutes an explicit exclusion or inclusion of statutory rates. Since we find no such express terms in either of the applicable clauses, the proceedings will be remanded to the presiding judge for the purpose of allowing the parties to make

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[26] These clauses are quoted on page 3, *supra*.

[27] Initial decision at 9.

offers of proof as to intent [28] and for such further proceedings, including a hearing, as he may consider necessary.[29]

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[28] Certain parties argue that further evidentiary proceedings in this case are unnecessary because, if probative evidence of intent existed, it would have been offered by now. This may be true, and if it is, the presiding judge should be able to bring this matter to an expeditious conclusion. But we must take cognizance of the fact that the chief administrative law judge at the outset ruled out an evidentiary hearing because he determined that this case presented only legal issues, and he stated only that Consolidated was "not estopped" from submitting evidence in written form. See page 4, *supra*. On this record, we can not be satisfied that the parties were not dissuaded by the Chief ALJ's procedural orders from availing themselves of the opportunity to present such reliable and probative evidence as they believe may shed light on the intent of the parties. We therefore now provide that opportunity.

[29] We are proceeding in this case, as did the presiding judge, on the assumption that the settlement agreements are the controlling legal instruments with respect to the issue of contractual authorization to collect statutory rates. See initial decision at 6. Carnegie contends, however, that because its contracts with the IOGA producers specifically preclude superseding rates, our construction of the area rate clauses in the settlements would not be applicable to Carnegie in any event. IOGA, on the other hand, regards the settlements to have superseded and modified the applicable contracts. IOGA relies on the provisions in the settlements which required the purchasers to offer to modify all existing contracts so that they would be consistent with the terms of the settlements. The agreement in Docket No. RI75-21 also required all future contracts relating to wells commenced on or after January 1, 1976 to be consistent with the settlement provisions. Since neither Carnegie nor IOGA has explained why the Carnegie contracts apparently did not conform to the area rate clauses in the settlement agreements, Carnegie's assertion should be addressed by the presiding judge on remand.

In those cases where the pipelines and producers did modify their contracts in accordance with the settlements, the texts of the contractual provisions, if not ambiguous, may help to clarify the meaning attached by the parties to the area rate clauses in the settlement agreements. See our discussion at page 18 above concerning the significance accorded to the parties' interpretation of an ambiguous agreement.

Because this proceeding involves settlements rather than contracts, we must address the question raised by the Public Service Commission of the State of New York concerning the privileged status of settlement negotiations. In *Texas Eastern Transmission Corporation,* 48 F.P.C. 1170, 1178-79 (1972), the FPC, in upholding a claim of privilege with respect to settlement negotiations, observed that "[t]o permit a party to settlement procedures to disclose and to attempt to make use of prior positions taken or the details of the settlement process would be very prejudicial to the settlement of proceedings." We agree with the policy established by the FPC in that case. Consequently, if any of the parties which participated in the settlement negotiations in these dockets asserts such a privilege, evidence of the conduct or the statements of the parties made during the course of such negotiations will not be admitted. In that event, the presiding judge may consider only such reliable and probative evidence as would not violate the privilege.

If the presiding judge determines, upon remand, that a hearing is not warranted on the basis of the offers of proof, or if the evidence submitted at a hearing proves to be inconclusive, an initial decision shall be rendered based upon the terms of the settlement agreements in accordance with the interpretive standards adopted in this order. Upon examination of the relevant provisions of the settlements in both dockets, we find that the substantial differences between them require us to reach different conclusions as to the legal effect of each clause.

Unless demonstrated otherwise by extrinsic evidence, the area rate clause in Docket No. RI74-188 (the "old gas" settlement) appears to limit escalation to administratively established, cost-based rates. The clause speaks of the "the issuance by the Commission, or any successor governmental authority . . . of a valid order establishing a just and reasonable ceiling rate. . . ." As a threshold matter, we agree

with the presiding judge that the phrase "valid order" signifies an agency determination.[30] Also, the reference to a "successor governmental authority" must be understood, in the context of this particular clause, to refer to a successor agency rather than Congress.[31] The clause also expressly joins that agency action with the "just and reasonable" standard of the Natural Gas Act, and there is no additional language which uncouples the link established in the text between administrative action and the statutory standard of the Natural Gas Act. Consequently, absent reliable and probative evidence of a contrary intent of the parties, the judge shall find that the old gas settlement clause authorizes collection of only those rates prescribed in Sections 104 and 106(a) of the NGPA.[32]

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[30] We note, however, that one of the grounds for the judge's conclusion—his reliance on the definition of "order" in the Administrative Procedure Act—was erroneous. Since the APA definition (5 U.S.C. § 551(b)) specifically excludes rulemaking, the judge's construction would compel the conclusion that the clause would not be triggered by the establishment of new area or nationwide rates in rulemaking proceedings. Such a result would, in our view, be contrary to the intent of the parties. Indeed, the FPC held in 1977 that the area rate clause in Docket No. RI75-21 authorized collection of the rates established in Opinion No. 770, which, while denominated an order, was the culmination of a rulemaking proceeding. See note 2, *supra*. There is no reason to believe that the result would have been any different if the clause in Docket No. RI75-21 had referred only to "order" rather than to "order, decision, or policy." Therefore, the term "order," as used in Commission practice, is not necessarily restricted to the APA definition.

[31] In Order 23 (mimeo, p. 44, n. 42), we withdrew our previous assertion that Congress could not be considered a "successor" under a "plain meaning" construction of a contract. But that does not mean that "successor" must always be read to include Congress. The term must be interpreted *in the context of the clause as a whole.*

[32] The judge rejected the argument of Consolidated and the staff that the Section 104 inflation adjustment was authorized by

In contrast, the language in Docket No. RI75-21 (the "new gas" settlement), while not crystal clear, suggests that the parties contemplated escalation of prices to whatever levels would be permitted by law. The clause provides for higher rates upon "the issuance by the Commission, or any governmental authority . . . of an order, decision or policy establishing a rate or rates. . . ." Thus, the clause omits the term "successor," expands "order" to include "decision or policy,' and contains no reference to the Natural Gas Act or the statutory standard of that Act. Taken together, these factors point toward an intent to allow prices to rise to the highest legally permissible rates. In this connection, we are unable to accept the conclusion of the presiding judge that "issuance of policy" can not constitute a reference to Congressional action. Indeed, we find that conclusion rather strained. We believe that that phrase is sufficiently broad to encompass a legislative enacement,[33] and that, when read in conjunction with the omission of "successor"[34] and of any reference to a stand-

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the old gas settlement. He stated that "[t]here is no difference between Section 104 and any other section of Title I [of the NGPA], they are all rate provisions established by Congress, not the FERC." Initial decision at 10. We conclude otherwise. See note 19, *supra*.

[33] The Supreme Court has stated that "[t]he essentials of the legislative function are the determination of the legislative policy and its formulation as a rule of conduct." *Opp Cotton Mills, Inc. v. Administrator*, 312 U.S. 126, 145 (1941). We do not here hold that "issuance of policy" constitutes an unambiguous reference to the legislative process. If that were so, there would be no need for a remand. We simply reject the notion that the phrase must be construed as a reference to agency action alone.

[34] The judge recognized that it was necessary to reconcile the elimination of "successor" with his conclusion that only agency action was covered. He resolved the problem by accepting the suggestion of the Public Service Commission of the State of New York that "[m]ore likely than not, . . . the word was eliminated in recognition of the possibility that state agencies or federal

ard for establishing rates, the clause in its totality manifests an intent to authorize collection of statutory rates. Accordingly, the presiding judge shall so conclude unless the parties can establish a contrary intent by reliable and probative evidence.

In its brief opposing exceptions, the Public Service Commission of the State of New York (PSCNY) emphasizes that both settlement agreements provide that in the event of deregulation, redeterminations of prices will be based on a cost-based formula. PSCNY appears to suggest, as previously argued by Equitable,[35] that if the producers were willing to accept rates derived through a cost-based formula in the event of total deregulation, they would not have contemplated receiving higher, non-cost-based statutory rates if Congress were to prescribe such rates rather than deregulate.

We do not believe that the deregulation clauses are, on their face, dispositive of the question of the parties' intent with respect to the area rate clauses. For one thing, the area rate clauses contain the introductory language "Notwithstanding anything to the contrary in this settle-

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agencies, while not being successors to the FPC, might at some future point have regulatory jurisdiction." Initial decision at 16. This explanation, apart from its speculative character, is not persuasive on its face. It would require us to conclude, without supporting evidence, that the parties in fact contemplated the possibility of significant legislative action (since only through legislation could the FPC's jurisdiction have been eliminated or transferred to a non-successor agency) and were prepared to tie their destiny to the determination of an agency whose identity, procedures, and ratemaking methodology were unknown, but that they nevertheless declined to be bound by direct Congressional ratemaking. If that was indeed what the parties intended, they will have an opportunity to so demonstrate by reliable and probative evidence.

[35] See Equitable's motion for expedited decision, filed May 8, 1979, pp. 1-2.

ment proposal. . . ." Furthermore, it is possible that the parties regarded a cost-based formula as the only feasible means of restricting price escalations to a reasonable level in an environment of complete deregulation, but that they were fully prepared to accept a different and higher limit imposed by Congress. However, the argument raised by PSCNY and Equitable merits further inquiry, and the parties should have the opportunity to submit reliable and probative evidence bearing on the issue of whether and to what extent the intent of the parties in adopting a cost-based approach in the deregulation clauses bears any relationship to their intent in regard to the area rate clauses. Accordingly, the parties may, on remand, make appropriate offers of proof on that question.

VI.

Another issue which must be resolved in this proceeding is the date from which NGPA prices may be collected. There is a dispute between Consolidated, on the one hand, and IOGA and the staff, on the other, as to whether the producers are entitled, pursuant to the applicable settlement agreements, to collect NGPA rates on a retroactive basis where they have elected not to follow the Commission's procedures for making interim collections subject to refund.

The presiding judge ruled that this issue was moot in light of his conclusion that the settlement agreements do not authorize the collection of NGPA rates. Inasmuch as the Commission's holdings in this order remove the mootness, we will remand the issue to the presiding judge.[38]

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[38] On February 12, 1980, IOGA filed a motion for severance and expedition in which it states, among other things, that Equitable and Carnegie are not permitting IOGA producers to make interim collections of NGPA prices pursuant to the Commission's regulations, and requests the Commission to resolve the controversy. Although IOGA does not refer to a previous pleading in

VII.

We have also been asked to determine whether certain alleged actions of Equitable Gas Company in resisting payment of the higher NGPA rates constituted violations of the Natural Gas Act. This matter arose as a result of an Emergency Petition for Declaratory Order, filed on July 6, 1979, in which IOGA made certain charges against Equitable and requested appropriate findings and relief from the Commission. Specifically, Equitable sent a letter to IOGA members in June 1979 threatening to exercise its contractual rights to refuse to purchase gas from them for the period July 9 to November 1 unless they waived their right to collect NGPA prices during this period.[37] IOGA sought a ruling that Equitable could not compel such a waiver; a finding that the shut-ins of wells as a result of Equitable's letter constituted a *de facto* abandonment of service by Equitable in violation of Section 7(b) of the Natural Gas Act; and a finding that Equitable's contract with IOGA members permitting curtailment of deliveries during a six-month period is unjust and unreasonable under Sections 4 and 5 of the Natural Gas Act. The Chief ALJ consolidated for decision IOGA's emergency petition with the instant proceeding.

The presiding judge's rulings on the emergency petition were based primarily on his conclusion that the IOGA producers were not contractually entitled to NGPA rates. Thus, he held that the waiver issue is moot, and that Equitable would not cause any shut-ins or curtail purchases if,

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which it raised this issue, it would be appropriate, in the interest of administrative efficiency, for the presiding judge to permit the parties to file pleadings on this matter and to address it in his initial decision together with the retroactive collection question. Accordingly, we will consolidate the interim collection issue with the instant proceeding and refer it to the judge for initial decision.

[37] Equitable's contract requires it to take gas during the summer months only "if and as needed".

as he had concluded, the producers were limited to existing gas prices.

The staff, however, urges that because the judge's decision on NGPA rates was erroneous, these issues are not moot. The staff also contends that the judge ignored the uncontested fact that ten producers had shut in their wells as a result of Equitable's letter.[38] The staff further believes that Equitable's conduct was violative of the Natural Gas Act even if the Commission ultimately determines that NGPA rates are not authorized by the settlements. IOGA also claims that a hearing is required on the petition regardless of the outcome of the contract dispute.

Equitable vigorously defends its actions on the grounds that it was in an oversupply situation and wishes to prevent its customers from paying more than legally required. It also disputes certain factual allegations made by the staff, including the suggestion that Equitable might be paying other producers higher prices than the IOGA members would have received if they had been entitled to NGPA rates, and the charge that the shut-ins may result in the permanent loss of natural gas.

Since it appears that resolution of the matters raised in the emergency petition would not necessarily depend upon our conclusions with respect to the interpretation of the area rate clauses, and in light of the existence of disputed issues of fact in regard to the petition, the emergency petition will be remanded to the presiding judge for a hearing.

VIII.

On June 26, 1979, IOGA filed a petition for declaratory order raising the question of whether the price escalator

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[38] Equitable states in its answer to the briefs on exceptions that after the initial decision was issued, Equitable advised the ten producers to resume production.

clause in the Docket No. RI75-21 settlement agreement, as interpreted by the Commission in this proceeding, is applicable to *future* gas purchase contracts between the four pipelines and the IOGA producers. This is a different issue from the one discussed above. We have previously dealt with the question of whether the area rate clause should be interpreted as authorizing collection of NGPA rates. The instant petition, however, requests the Commission to determine whether, if the clause does authorize NGPA rates, all new contracts must require the pipelines to pay the statutory rates rather than such lower prices as the parties may establish through negotiation.

IOGA asserts that certain of the pipelines have offered contracts to IOGA producers which provide for rates lower than the maximum ceiling prices prescribed in the NGPA, and that some producers may be compelled to accept those contracts unless the Commission issues a declaratory order stating that the area rate clause must continue to govern future contractual relationships.[39] IOGA, in contending that the settlement mandates adoption of statutory rates in future contracts, relies on paragraph 7 of the settlement agreement, which states in part:

> Whether or not now in existence, Contracts in respect of wells first commencing jurisdictional sales on or after January 1, 1976, shall contain provisions consistent with the provisions hereof and shall specify a price at least equal to the higher of the Adjusted Prices, as theretofore increased, pursuant to Paragraph 3 hereof.

IOGA further states that the settlement was intended to provide some measure of protection to producers whose

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[39] IOGA also requests that the Commission declare unenforceable any provisions in new contracts to which producers may have felt compelled to assent which are inconsistent with the area rate clause in the settlement agreement, as interpreted by the Commission.

bargaining power is negligible vis-a-vis the interstate pipelines in West Virginia, and that in the absence of deregulation, the pipelines shoud adhere to their bargain and purchase gas at the applicable NGPA ceiling rate.

Consolidated and Columbia have filed responses opposing IOGA's petition.[40] Consolidated argues that as a matter of contract law, an agreement which does not expressly limit the time for continued performance is construed to extend for a reasonable time only. Accordingly, Consolidated asserts that the future contract provision in paragraph 7 of the settlement agreement should be interpreted to require price escalator clauses in future contracts only for a commercially reasonable time. In this regard, Consolidated believes that the incentives for production embodied in the NGPA have significantly diminished the need for perpetual extension of the future contracts provision in paragraph 7 of the settlement.

Columbia contends that the settlement agreement should be interpreted as having expired as to new gas purchases on the effective date of the NGPA. It claims that area rate clauses were necessary under the regulatory system in effect under the Natural Gas Act but that they are now inconsistent with the objectives of the NGPA and with the public interest. Specifically, Columbia argues that under the Natural Gas Act, producers would not have been entitled under their contracts, absent an escalator clause, to collect new area or nationwide rates established by the Commission despite justification under the Natural Gas Act for such new rates. However, Columbia says, the NGPA generally removed pricing authority from the Commission and was intended to permit competitive forces to determine pricing decisions, subject to the ceilings prescribed in the statute. Columbia also requests that the

[40] As stated above, both of these pipelines agree with IOGA that the area rate clause in the new gas settlement authorizes collection of NGPA rates.

Commission, if it concludes that the settlement must be interpreted as IOGA suggests, reopen the proceeding and terminate the settlement prospectively as to new gas purchases.

By order dated July 26, 1979, the Chief ALJ denied Consolidated's request that IOGA's June 26 petition be consolidated for decision with this proceeding, in part because the petition had not been noticed or docketed and was therefore not properly before him. Hence, the initial decision did not discuss the issues raised in that petition. The staff, in its brief on exceptions, renews the request for consolidation. We agree that the issues involved in the petition are sufficiently related to the other questions in this case to warrant consolidation, and we will so order. We will also refer IOGA's petition to the presiding judge for initial decision. The judge will be authorized to establish such procedures (including a hearing, if he determines that there are disputed material issues of fact) as may be necessary to resolve the issues raised in the petition and related pleadings.

It is essential, however, that the proceedings involving IOGA's petitions for declaratory orders not delay the resolution of the issues of whether there is contractual authorization to collect NGPA rates and, if so, whether such rates may be collected on an interim or retroactive basis. Hence, the presiding judge shall issue a decision on those issues as soon as practicable, whether or not the proceedings with respect to IOGA's petitions have been completed.[41]

The Commission orders:

(A) The initial decision of the presiding judge is reversed and the proceeding is remanded to the presiding

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[41] IOGA has moved for the opportunity to present oral argument before the Commission on the issues in this proceeding. It does not appear that further elaboration of the views expressed by the parties in their respective briefs is necessary in this case. Accordingly, IOGA's motion will be denied.

judge for further proceedings in accordance with the directions provided in the body of this order.

(B) The Petition for Declaratory Order With Respect to Pricing Provisions in New Gas Purchase Contracts, filed by IOGA on June 26, 1979, is consolidated for decision with this proceeding and is referred to the presiding judge for initial decision.

(C) The issue of interim collections raised by IOGA in its motion of February 12, 1980 is consolidated for decision with this proceedings and is referred to the presiding judge for initial decision.

(D) Pursuant to the authority of the Natural Gas Act, particularly Sections 4, 5, 7, 8, 15, and 16, and the Commission's rules and regulations, a hearing shall be held in this proceeding on the issues raised in the Emergency Petition for Declaratory Order filed by IOGA on July 6, 1979, and, if the presiding judge determines it is necessary, on the issues raised in the petition referred to in paragraph (B) above and on any other issues which must be resolved in this proceeding.

(E) The presiding judge shall convene a conference as soon as practicable for the purpose of establishing procedures for this proceeding. The presiding judge shall be authorized to establish and modify all procedural dates, to consider and rule upon pertinent offers of proof and stipulations of facts, and to establish such further procedures as may in his judgment be required for purposes of this proceeding.

(F) Ashland Oil, Inc., Texas Independent Producers and Royalty Owners Association, Cities of Charlottesville and Richmond, Virginia, Four Corners Gas Producers Association, Mesa Petroleum Company, Tenneco Oil Company, Pennzoil Company, Pennzoil Producing Company, Pennzoil Oil and Gas, Inc., and Pennzoil Louisiana and Texas Offshore, Inc. are permitted to intervene in this

proceeding, subject to the rules and regulations of the Commission; *provided, however,* that the participation of such intervenors shall be limited to matters affecting asserted rights and interests as specifically set forth in their petitions to intervene; and *provided, further,* that the admission of said intervenors shall not be construed as recognition by the Commission that they may be aggrieved because of any orders of the Commission entered in this proceeding.

(G) The motion of Ashland Oil, Inc. for leave to file its brief out of time is granted.

(H) IOGA's motion for oral argument is denied.

(I) The Secretary shall cause prompt publication of this order to be made in the Federal Register.

By the Commission. Commissioner Holden, concurring in part and dissenting in part, will have a separate statement which will be forthcoming.

(SEAL)

Kenneth F. Plumb, Secretary.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Small Producer Rates

Before Commissioners: Charles B. Curtis, Chairman, Georgiana Sheldon, Matthew Holden, Jr., and George R. Hall.

Docket No. CI78-705

ARAPAHOE PRODUCTION COMPANY

v.

PANHANDLE PRODUCING COMPANY, *et al.*

ORDER GRANTING RELIEF, AND GRANTING PETITION TO INTERVENE OUT OF TIME

(Issued April 13, 1979)

Background

On April 28, 1978, Arapahoe Production Company (Arapahoe), a small producer certificate holder in Docket No. CS71-1002, filed an application for relief in Docket No. CI78-705, stating that Panhandle Producing Company, *et al.* (Panhandle) refuses to pay it the small producer rates [1] for gas produced since August 28, 1975, for sales from certain gas reserves that Arapahoe purchased from Gulf Oil Corporation (Gulf) in 1969. The properties involved are located in Hutchinson County, Texas, and were developed by Gulf, a large producer, prior to being sold to Arapahoe.

Arapahoe alleges that Panhandle refuses to abide by Order No. 428-B which provides that the blanket certificate

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[1] Base rates of 66.3¢, 67.6¢, 68.9¢ and 70.2¢ for gas sold in 1975, 1976, 1977 and 1978, respectively, as adjusted for tax and Btu content. Apparently, Panhandle is paying some monies to Arapahoe on a continuing basis, but is withholding a portion of these rates pending resolution of this issue by the Commission.

authorization prescribed therein is applicable to small producer sales made from large producer developed reserves acquired prior to March 18, 1971. Arapahoe contends that it cannot afford to continue service to Panhandle at a rate of less than it is entitled to under its contract and the Commission's regulations. Therefore, Arapahoe requests that it be permitted to abandon the sale to Panhandle provided that Arapahoe thereafter continues to sell the gas in interstate commerce under terms no less favorable than those contained in its contract with Panhandle. Arapahoe contends that it is not asking for an adjudication of the contractual rights between Arapahoe and Panhandle, but rather is directing its request for relief to its obligation under the Natural Gas Act.

On May 8, 1978, Panhandle filed a response to Arapahoe's application denying that Arapahoe is entitled to the requested relief. Panhandle contends it was Opinion No. 742, issued August 28, 1975, not Order No. 428-B, which authorized a small producer rate not to exceed 130% of the Commission determined base ceiling rate applicable to a comparable large producer, and that Opinion No. 742 expressly provided as follows:

> "Rate regulation as prescribed herein shall not apply to any jurisdictional sales made by a small producer where the gas reserves relating thereto were acquired by the purchase of developed reserves in place from a large producer."

Panhandle states that Arapahoe, having acquired the developed reserves from a large producer, is not entitled to the rates authorized under Opinion No. 742.

Panhandle also advised in its response that Arapahoe has filed suit against Panhandle in the District Court of Hutchinson County, Texas, seeking the same pricing relief

as requested from the Commission.[2] Panhandle contends that the dual filing of the suit and the application for relief exposes Panhandle to the possibility of double jeopardy and that by filing such suit Arapahoe has recognized that the pricing aspect involves private contractual rights which can be determined by the court. Therefore, Panhandle requests that Arapahoe be denied its relief respecting price or stay a ruling until Arapahoe's rights are judicially determined.

Additionally, Panhandle states that Arapahoe's request for abandonment is not in conformity with the Commission's regulations. Panhandle requests that the Commission either deny the abandonment or require supplemental information to make the application conform with the requirements of the Regulations.

On May 12, 1978, Arapahoe responded to Panhandle's comments and stressed that there is nothing in Opinion No. 742 to indicate that the Commission's prior treatment of small producer sales from large producer developed reserves was intended to be modified. Since Order No. 428-B specifically denied small producer rate treatment to sales from large producer developed reserves acquired by small producers on or after March 18, 1971, Arapahoe contends that the Commission by definition found pre-March 18, 1971, acquisitions to be subject to small producer rate treatment. Moreover, Arapahoe notes that this point is clarified by Order No. 568, issued on July 14, 1977, which defines small producer reserves, in part, as ". . . developed reserves held on March 17, 1971, by a small producer, regardless of whether such reserves were developed by a large or small producer . . . ." Arapahoe contends that in so providing, Order No. 568 simply continues in effect the policy which

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[2] Since this is a matter of the regulation of small producers, under *Ashland Oil & Refining Co.* v. *FPC*, 421 F2d 17 (CA6, 1970) the Commission has the authority to proceed regardless of the existence of the proceeding in the state court.

the Commission adopted in Order Nos. 428 and 428-B and that it is illogical and arbitrary that Order No. 742 should be interpreted differently.

Arapahoe further states that Panhandle had previously refused to pay the small producer rate on the Gulf developed reserves because of a dispute as to whether such rates were contractually permitted. However, Arapahoe claims that in a letter dated December 14, 1977, Panhandle finally admitted that such rates were contractually permitted, but then refused to pay the small producer rate allegedly because of the provisions of Opinion No. 742.

In its supplement, Arapahoe also refers to the litigation against Panhandle in the District Court of Hutchinson County, Texas, to recover the small producer increment and to Panhandle's reference in its response to "double jeopardy". Arapahoe states that if Panhandle pays Arapahoe the small producer increment, Arapahoe will have to dismiss both this proceeding and the state court proceeding. Arapahoe goes on to say that before the state court can determine the rights of Arapahoe under state law, a determination must be made as to what Arapahoe's rights are under the Natural Gas Act, and that this Commission, not the state courts in Texas, is best situated to make this determination.

Public notice of the application for relief was issued on June 5, 1978, publication in the Federal Register being on June 12, 1978 (43 FR 25369). On July 7, 1978, Colorado Interstate Gas Company (CIG) filed its Petition for Leave to Intervene Out of Time stating that the volumes of gas purchased by Panhandle from Arapahoe are, after processing sold and delivered by Panhandle to CIG, together with gas purchased by Panhandle from other producers in the area, and all comingled by CIG with its other gas supplies in Texas and transported or sold for resale in interstate commerce, and the relief requested, if granted, would have an effect upon CIG and upon its customers.

Discussion

It is clear that the Commission did not intend to exclude from coverage under a small producer certificate reserves acquired from a large producer prior to the issuance of Order No. 428 because the Commission specified in Order No. 428-B, mimeo pp. 11-12:

> "Finally, the blanket certificate authorization is applicable to jurisdictional sales made by a small producer from gas reserves acquired prior to the issuance of Order No. 428 by the purchase of developed reserves in place from a large producer. The problem sought to be solved in Section 157.40(c) by the exclusion from blanket authorization of sales from certain gas reserves has no applicability to previously acquired reserves. However, for acquisitions of developed reserves in place made on or after the issuance of Order No. 428, a small producer must apply for separate certificate authorization for jurisdictional sales relating thereto regardless of whether the large producer who sold the reserves in place retained any rights or reversionary interest in the properties involved."

While the wording of Section 157.40(c), to the extent here relevant, was modified slightly in Opinion No. 742, in all material respects it remained the same as that promulgated in Order No. 428. Moreover, there is nothing in the text of Opinion No. 742 which would suggest that the Commission had any intention of modifying Section 157.40(c) in the fashion claimed by Panhandle.

Arapahoe has properly construed the Commission's intention with regard to the rate treatment to be applied to small producer sales from acquired large producer developed reserves. That is, small producers can receive a higher rate to the extent that the small producer acquired such reserves *before* the Commission established different rate treatment for small producer sales in Order No. 428 on

March 18, 1971. Panhandle's interpretation would disqualify small producer rate treatment to all reserves developed by large producers irrespective of the date of small producer acquisition. This position is erroneous. Since Arapahoe acquired reserves developed by Gulf in 1969, well before the issuance of Order No. 428, it should be accorded small producer rate treatment to the extent contractually permitted.[3]

In view of the above, we do not reach Arapahoe's request for abandonment authority or other contingent avenues of relief.

In certain of its filings Panhandle has made allegations regarding certain communications between Arapahoe and members of our technical staff, which communications Panhandle has labeled as *ex parte*. We have inquired into the substance of and circumstances and timing surrounding the communications and find the allegations to be groundless.

We are gravely concerned with any suggestion that our processes are not fundamentally fair, and consequently we have explored this allegation thoroughly to determine if Panhandle suffered any prejudice whatsoever in this matter because of Arapahoe's communications.[4]

The facts are that a representative of Arapahoe talked on the telephone with two members of the staff of the Office

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[3] Arapahoe has submitted a copy of its April 1, 1975, replacement contract with Panhandle which contains an area rate clause and appears to permit collection of the claimed rates.

[4] The inquiry went considerably beyond the technical question of compliance with our regulations. Under 18 C.F.R. 1.4(d), *ex parte* communications pertain to *pending* proceedings. Here, the two communications took place on April 24, 1978, and Arapahoe's applications was not filed until April 28, 1978. Thus, there was no violation of our regulations.

of Pipeline and Producer Regulation on April 24, 1978. According to the staff members, the Arapahoe representative's questions related generally to the treatment accorded gas produced from small producers' wells where the wells had been developed by a large producer but sold to the small producer prior to the issuance of Order 428. The Commission's staff members cited language from Order 428-B—specifically, the paragraph continuing from the bottom of 46 FPC 52 to the top of 53—as dispositive. Apparently, Arapahoe then advised Panhandle of its communications with our staff, and did so prior to Panhandle's filing on May 8 of its reply to Arapahoe's application.

Thus, the staff members concerned (who are not lawyers) simply referred Arapahoe to what they regarded to be the pertinent text of Federal Power Commission orders. In so doing, and in stating that the language from Order 428-B governed in this situation, they were merely voicing established Commission policy and practice, for the Commission had earlier dealt with situations that were identical on all pertinent facts.[5] Moreover, the two staff members did not appear before or advise the Commission in its deliberations on this matter.

In sum, we see no element of unfairness or prejudice to Panhandle arising out of the communications: Panhandle was given prompt disclosure of the communications, the staff members merely communicated established Commission policy, Panhandle had a full opportunity to respond, and did so, and the Commission's decision did not depend—indeed, was not at all influenced—by anything the staff members said which might in turn have been said by

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[5] *See*, Order issued June 10, 1976 in CS66-57, *et al.*, Appendix A, p. 2, n.13; as well as letters from Secretary dated March 11, 1977 to Texlan Oil Company, Inc., reply reference number BNG-231, and dated May 5, 1976 to Mr. Franklin E. Bernsen in Docket Nos. CS72-647 and CS76-548.

Arapahoe's representative in the two conversations with staff members.

The Commission finds:

(1) Arapahoe is entitled to small producer rate treatment with respect to gas delivered to Panhandle on and after August 28, 1975, from the developed reserves acquired from Gulf in 1969.

(2) Participation in this proceeding by Colorado Interstate Gas Company may be in the public interest.

(3) Panhandle's allegations of *ex parte* communications are without merit and any requested relief based thereon should be denied.

The Commission orders:

(A) Arapahoe is entitled to small producer rate treatment with respect to gas delivered to Panhandle on and after August 28, 1975, from the developed reserves acquired from Gulf in 1969.

(B) CIG is hereby permitted to intervene in this proceeding subject to the rules and regulations of the Commission; *Provided, however,* that the participation of such intervenor shall be limited to matters affecting asserted rights and interests as specifically set forth in the petition to intervene; *Provided, further,* that the admission of such intervenor shall not be construed as recognition by the Commission that it might be aggrieved because of any order of the Commission entered in this docket.

(C) All other requests of the parties for relief are hereby denied.

By the Commission.

(SEAL)

Lois D. Cashell,
Acting Secretary.

Louisiana Law Review (1980). The Work of the Louisiana Appellate Courts for the 1978-1979 Term—Mineral Rights, pages 588, 601-602

MINERAL RIGHTS

Patrick H. Martin *

The tempo of litigation concerning mineral rights appears to have increased in the past year. Undoubtedly the state bar can expect this trend to continue for several reasons. Drilling activity for oil and gas has increased in recent years. This is attributable to increased demand and to greatly increased prices allowed under federal regulations for both crude oil and natural gas. And with the price increases, it has become profitable to rework older fields or undertake enhanced recovery techniques that a short time ago would have been economically or technically unfeasible.

As a result, the rights to produce minerals and enjoy their revenues have become more valuable, giving property claimants an ever greater incentive to establish their rights. Claims will increase as some lessors come to feel their leases are unfair, many of them executed at a time when a one-eighth royalty and low bonus and delay rental prevailed, while their neighbors with more recent leases enjoy much higher income. Additionally, landowners whose properties are burdened by servitudes reserved or granted under far different economic circumstances are likely to assert the invalidity of those rights.

The next several years will be very important ones in the development of Louisiana mineral law. The Mineral Code, effective January 1, 1975, is still quite new, and relatively few cases have arisen under it. In the background, and heavily affecting traditional property rights

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issues, is a complex mass of federal regulations presenting problems for all parties to which a state court should be sensitive. There will be many significant cases, and the courts will have the opportunity to render decisions that can provide for certainty and stability in an area of the law that is acutely important for this state. If they fail, the effects will be felt for a generation, not only by mineral rights owners and claimants but also by the other citizens of the state and, indeed, the country.

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Gas Purchase Contract Litigation

Another area of the law that has produced significant litigation in the past term is gas purchase contract problems. Such contracts are complex and are today significantly affected by federal regulation under the Natural Gas Act of 1938 [43] and now the Natural Gas Policy Act of 1978.[44] A division between "interstate gas" and "intrastate gas" has profoundly influenced production and marketing in the past, and on "interstate gas," gas purchase contract terms have been dictated by the Federal Power Commission (recently succeeded by the Federal Energy Regulatory Commission).

Payment of Royalty; Purchase of Gas; Favored Nation Clause

The Louisiana Supreme Court issued a significant decision in one gas purchase contract case, *Hall* v. *Arkansas-*

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[43] 15 U.S.C. §§ 717-17w (1976).

[44] 15 U.S.C.A. §§ 3301-432 (1979).

Louisiana Gas Co.[45] The controversy arose from a contract pertaining to the Sligo field in Bossier Parish for the purchase of gas by the defendant Arkansas-Louisiana Gas (Arkla) for a term of twenty-eight years, beginning in 1952. The agreement contained a "two party favored nation" clause in which Arkla promised that, should it purchase gas from any other seller in the field at a higher price, it would escalate the purchase price to the sellers (plaintiffs here) under the 1962 agreement to the same price. In 1961 Arkla acquired, through an assignment, a fifteen percent working interest in an oil and gas lease granted by the United States on land in the Sligo field. As a lessee under this lease, Arkla was bound to pay a royalty to the United States; the United States could elect to be paid its royalty in kind or on the basis of the fair market value attributed to its percentage of production. The government chose the latter method; and, unlike other lessors, the government had the power under the lease to specify the value of the gas for purposes of royalty computation. The value specified by the government for Arkla's royalty was higher than the purchase price paid by Arkla to the plaintiffs under the 1952 gas purchase contract. The plaintiff's brought suit claiming the royalty payment was a purchase within the meaning of the favored nation clause, thus triggering an escalation of the price. Although remanding the case for recomputation of damages, the supreme court affirmed the second circuit's affirmation of a trial court judgment for plaintiffs.

There are several troublesome aspects to the *Hall* case, but the most significant is the court's determination that a payment of royalty, in which the lessor has the option of taking the gas in kind and the power to specify the value upon which the royalty is paid, is a purchase of gas by the lessee. If the option of taking or not taking the gas was the lessee's, the taking of gas and the paying of

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[45] 368 So. 2d 984 (La. 1979).

a royalty would seem more clearly a purchase. And if the "price" paid for that gas were set by some factor other than the determination by the lessor of the gas's value, that would lend itself to the conclusion that there had been a "purchase." But such was not the case.

Consider the dilemma of the purchaser of gas who is also a producer in similar circumstances under the court's approach. Its only choices are to pay the royalty specified by the United States, and thus trigger the escalation clause, or to give up the lease when the government demands a royalty for gas valued at a higher level than the sale price of other gas in the field, and thus lose not only the royalty gas of the lessor but also all the working interest gas. Neither of these seems a very sound choice, and it brings out the point that the election of the *lessor* not to take gas in kind is not a purchase of the gas by his *lessee*. This is not to suggest that a regulatory agency could not for some purposes treat it as a sale of gas (or oil under a similar provision in a lease) or that the parties themselves could not define it to be a purchase. The issue is whether these parties meant to treat it as a purchase for purposes of the gas purchase contract escalation clause, and it is doubtful that most people in the industry would regard it as a purchase. Accordingly, it strikes this writer as a questionable proposition. Nevertheless, the supreme court allowed recovery for damages all the way back to the time when defendant first paid the higher royalty to the United States, even though the Federal Power Commission, which had jurisdiction over the purchase price, would have had to allow the operation of the escalation clause for there to have been damage.[46] The court felt it was the defend-

[46] The Federal Power Commission would allow price escalation clauses in very narrow circumstances after April 3, 1961, Order 242, 18 C.F.R. § 154.93, 27 Fed. Reg. 1356 (1962), and limited their operation in contracts in effect on June 7, 1954, Order 174-B, 18 C.F.R. § 154.94, 19 Fed. Reg. 8809 (1954).

ant's fault that prevented a determination on that issue by the F.P.C. at the time of the "purchase."[47]

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[47] The court relied on Civil Code article 2040 which provides: "The condition is considered as fulfilled, when the fulfillment of it has been prevented by the party bound to perform it." The only way in which the defendant "prevented" fulfillment of the "condition" (filing of a new rate schedule in hopes of getting F.P.C. approval of a higher rate) was failing to inform plaintiffs of the "purchase" by the defendant.